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# Conflict Minerals and Resource Extraction: Dodd-Frank, SEC Regulations, and Legal Challenges

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October 15, 2014

**Congressional Research Service**
7-5700
www.crs.gov
R43639

**CRS REPORT**
Prepared for Members and
Committees of Congress

# Summary

Two sections of the Dodd-Frank Wall Street Reform and Protection Act (Dodd-Frank) require that the Securities and Exchange Commission (SEC or Commission) issue regulations to make public the involvement of U.S. companies in conflict minerals and in resource extraction payments. Supporters of the Dodd-Frank conflict minerals statute and the SEC implementing rule believe that such disclosures could have an impact on the amount of violence involved with the mining of conflict minerals. Opponents of the statute and rule argue that they require disclosures that are arbitrary and capricious and that some of the required disclosures violate the First Amendment guarantee of freedom of speech. Supporters of the resource extraction statute and the SEC implementing rule believe that they are needed to achieve the goal of the transparency of payments made by resource extraction issuers to governments in order to foster reform and anti-corruption and to improve the tax collection process. Opponents believe that they are arbitrary and capricious and violate the First Amendment. Legal challenges to the statutes and regulations have occurred, based primarily on administrative law and First Amendment grounds.

Section 1502 requires that the SEC issue rules mandating the disclosure by publicly traded companies of the origins of listed conflict minerals. Soon after the SEC issued regulations to implement this provision, the National Association of Manufacturers and other plaintiffs challenged the rules on the bases of several arguments, two of which claimed that the SEC did not conduct an appropriate cost-benefit analysis before promulgating the rule and that the rules violated the Constitution's First Amendment freedom of speech guarantee (by forcing the companies to label their products). The U.S. District Court for the District of Columbia upheld the rules, and plaintiffs appealed the decision. The Court of Appeals for the D.C. Circuit largely upheld the SEC's authority to implement the rules but struck down the portion of the rules requiring issuers to describe certain products as having been "not found to be DRC conflict free." The court found that the requirement violated the First Amendment. The SEC has petitioned the court to rehear the case. Depending upon the outcome, the case could have an impact on the government's ability to impose disclosure requirements in many other contexts as well.

Section 1504 of Dodd-Frank requires the SEC to issue rules mandating resource extraction issuers to disclose payments made to a foreign government or the federal government for the purpose of the commercial development of oil, natural gas, or minerals. The SEC issued rules, and the American Petroleum Institute brought suit, arguing, among other things, that the SEC acted arbitrarily and capriciously in promulgating the rules, as well as that the rules violated the First Amendment. The U.S. District Court for the District of Columbia vacated the rules on administrative law grounds and did not reach most of the Administrative Procedure Act arguments and the First Amendment issues. The SEC is not appealing this decision and is, instead, working on Section 1504 rules that will take into consideration the court's decision. The SEC has not yet issued a new rule. On September 18, 2014, Oxfam filed a lawsuit in the U.S. District Court for the District of Massachusetts to force the SEC to issue a new resource extraction disclosure rule.

This report will be updated as needed.

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# Introduction

Congressional hearings, news reports over the past several years, and even the 2006 film *Blood Diamond* have brought increased attention to the mining and selling of conflict minerals. Generally defined, conflict minerals are "minerals mined in conditions of armed conflict and human rights abuses, notably in the eastern provinces of the Democratic Republic of the Congo [DRC].... "[1]

Resource extraction payments have also received global attention. The Extractive Industries Transparency Initiative, begun in 2002, is an organization made up of sponsoring countries (the United States is one), natural resource extractive companies, and other non-governmental organizations. Their goal is the transparency of all payments made by resource extraction issuers to governments.[2]

Concerned about the armed conflicts in the DRC and about the need for transparency of resource extraction payments, Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)[3] added two sections to deal with these issues. Both of the sections require the issuing of regulations by the Securities and Exchange Commission (SEC or Commission) in order to make public the involvement of U.S. companies in conflict minerals and in resource extraction payments. Very briefly, Section 1502 mandates the SEC to issue rules requiring the disclosure by publicly traded companies of the origins of listed conflict minerals. Section 1504 mandates SEC rules requiring resource extraction issuers to disclose payments made to a foreign government or the federal government for the purpose of the commercial development of oil, natural gas, or minerals. The SEC has issued final rules, and court cases have challenged the rules on several grounds.

# Section 1502 of Dodd-Frank

## Statute

Section 1502 of Dodd-Frank, codified at 15 U.S.C. Section 78m(p), mandates that the SEC issue regulations requiring publicly traded companies filing annual and other reports with the SEC to disclose annually the origins of conflict minerals necessary to its operations if the minerals originate from the Democratic Republic of the Congo (DRC) or an adjoining country. Congress enacted this requirement because of its belief that the "exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence and contributing to an emergency humanitarian situation therein.... "[4] If the minerals originate from the DRC or an adjoining country, the company must file a report with the SEC and include such information as a description of its due diligence on the

[1] http://en.wikipedia.org/wiki/Conflict_minerals. For purposes of this report, diamonds are not defined as "conflict minerals."

[2] http://eiti.org.

[3] P.L. 111-203, 124 Stat. 1376 (2010).

[4] Dodd-Frank, section 1502(a).

source and chain of custody of the minerals and a description of the products manufactured or contracted to be manufactured that are not DRC conflict free. (DRC conflict free products are products which do not contain minerals directly or indirectly financing or benefiting armed groups in the DRC or an adjoining country.) Dodd-Frank defines "conflict mineral" as: "(A) columbite-tantalite (coltan) [used to produce tin], cassiterite, gold, wolframite [used to produce tungsten], or their derivatives; or (B) any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country."[5]

## Regulations

On August 22, 2012, the SEC voted 3-2 to adopt final rules to require publicly traded companies to disclose information related to their use of conflict minerals.[6] 17 C.F.R. Section 240.13p-1 requires every company filing reports with the SEC having "conflict minerals which are necessary to the functionality or production of a product manufactured or contracted by that registrant to be manufactured" to file a report on Form SD[7] to disclose required information.

In complying with the requirements of Form SD, the company must in good faith conduct a reasonable country of origin inquiry concerning its necessary conflict minerals. If the company determines that its necessary conflict minerals did not originate in the DRC or an adjoining country or if the company reasonably believes that its necessary minerals came from recycled or scrap sources, it must disclose its determination and describe the inquiry it made in arriving at its determination. If, on the other hand, the company knows or has reason to believe that any of its necessary conflict minerals originated in the DRC or an adjoining country and are not from recycled or scrap sources, it must exercise due diligence on the source and chain of custody of the minerals. Depending upon the results of the due diligence, the company may be required to file a Conflict Minerals Report as an exhibit to its specialized disclosure report.

The Conflict Minerals Report must contain information about the registrant's due diligence and a product description. The company must use due diligence which conforms to a nationally or internationally recognized due diligence framework if a framework is available for the conflict mineral, including but not limited to an independent private sector audit in accordance with standards established by the Comptroller General; disclose steps that it has taken or will take if products are DRC conflict undeterminable to mitigate the risk that the minerals benefit armed groups; and exercise appropriate due diligence in determining the source and chain of custody of necessary conflict minerals if a recognized due diligence framework does not exist. The product description for products not found to be DRC conflict free or DRC conflict undeterminable must have a description of those products, the facilities used to process the necessary conflict minerals in those products, the country of origin of the necessary conflict minerals, and efforts to determine the mine or location of origin. If the necessary conflict minerals are from only recycled or scrap sources, those products may be considered DRC conflict free, thereby freeing a company from having to provide the above product information.

[5] Dodd-Frank, section 1502(e)(4).

[6] 17 C.F.R. §§240.13p-1 and 248.

[7] A copy of Form SD may be found at http://www.sec.gov/about/forms/formsd.pdf. Form SD is a new disclosure form to be used for specialized disclosure not included within an issuer's periodic or current reports.

The SEC made a number of changes from the proposed rule to the final rule, several of which were at the urging of business groups such as the Chamber of Commerce. Nevertheless, critics complained that compliance costs would be excessive and that, in many cases, companies, despite due diligence, would be unable to meet the SEC's requirements.[8] A legal challenge to the SEC's rule occurred.

## Legal Challenge

The National Association of Manufacturers (NAM), the Chamber of Commerce, and the Business Roundtable filed a lawsuit to challenge the SEC rule. *National Association of Manufacturers v. Securities and Exchange Commission*[9] challenged the rule on the basis of several arguments:

1. The SEC did not conduct a proper cost-benefit analysis, as required by Sections 3(f)[10] and 23(a)(2)[11] of the Securities Exchange Act.
2. The SEC incorrectly concluded that the statute did not allow it to adopt a *de minimis* exception (allowing only a trace amount of a conflict mineral) to the rule.
3. The rule improperly required due diligence and a report from a company having only a reason to believe that conflict minerals may have originated in the covered region.
4. The SEC required a company to use an extremely burdensome approach in tracing minerals back to their smelter or refiner.
5. The SEC mistakenly interpreted the statute to apply to companies which only contracted for the manufacture of products and did not actually manufacture any products.
6. The rule was inconsistent by giving small issuers four years to be able to trace conflict minerals in their supply chain but only two years for large issuers, many of whom may have to obtain information from small companies to meet their obligations.
7. The statute and the rule violated the Constitution's First Amendment guarantee of freedom of speech by requiring a company to describe its products as not DRC conflict free even when it is simply unable to trace its supply chains to determine the minerals' origins, thereby forcing a company falsely to associate itself with groups involved in human rights violations.

Amnesty International intervened as defendants in the case to defend the regulations.[12]

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[8] http://www.complianceweek.com/critics-of-secs-conflict-minerals-rule-speak-out-at-appeal-hearing/article/328332.

[9] No. 13-cv-635 (D.D.C. July 23, 2013).

[10] 15 U.S.C. §78c(f). "Whenever pursuant to this chapter the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."

[11] 15 U.S.C. §78w(a)(2). "The Commission and the Secretary of the Treasury, in making rules and regulations pursuant to any provision of this chapter, shall consider among other matters the impact any such rule or regulation would have on competition.... "

## Federal District Court Decision

On July 23, 2013, the United States District Court for the District of Columbia (D.C. District Court) held that the SEC complied with its cost-benefit analysis and other Administrative Procedure Act (APA) requirements and that it did not violate the Constitution's First Amendment.

In its analysis, the court placed the plaintiffs' arguments into two separate categories of claims:

1. The SEC, in issuing the rule, did not adhere to the Administrative Procedure Act (APA),[13] thereby ignoring its statutory obligations under the Securities Exchange Act[14] and engaging in rulemaking that was arbitrary and capricious.
2. The statute and the rule violated the Constitution's First Amendment freedom of speech guarantee.

### *Administrative Procedure Act Challenge*

In analyzing the plaintiffs' APA claims, the court started with the APA statutory language that agency action is unlawful if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[15] The court then discussed cases that have ruled that the arbitrary and capricious standard is narrow and that a court cannot substitute its judgment for the agency's judgment. ("[T]he agency's action remains 'entitled to a presumption of regularity,' *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 414-16 (1971).")[16] Nevertheless, the court must be satisfied that the agency's statutory interpretation has a rational connection with the choice that it has made.

The Supreme Court in *Chevron U.S.A., Inc. v. Natural Resources Defense Council*[17] limited a court's role in reviewing agency interpretations of statutes.[18] The D.C. District Court discussed the two-part *Chevron* test in examining the SEC's interpretation of the statute. Under the *Chevron* test, the court must first determine "whether Congress has directly spoken to the precise question at issue"[19] (Step One). If so, the court's inquiry ends and the statutory language controls. If the statute is ambiguous, the reviewing court must consider whether the agency's interpretation is a permissible interpretation of the statute (Step Two).

(...continued)

[12] "The Democratic Republic is facing escalating conflict, killings, and displacement," said Suzanne Nossel executive director of Amnesty International USA. "Strict legal requirements are needed to prevent corporate interests and profit-seeking from fueling human rights abuses.... Amnesty International USA has spent years working to expose and eliminate links between these minerals and violence in the region." http://www.amnestyusa.org/news/press-releases/amnesty-international-to-defend-conflict-minerals-reporting-requirements-from-attacks-by-corporate-g.

[13] 5 U.S.C. §§551 *et seq*.

[14] 15 U.S.C. §§78a *et seq*.

[15] 5 U.S.C. §706(2).

[16] No. 13-cv-635 (D.D.C. July 23, 2013), at 16.

[17] 467 U.S. 837 (1984).

[18] *See* CRS Report R43203, *Chevron Deference: Court Treatment of Agency Interpretations of Ambiguous Statutes*, by Daniel T. Shedd and Todd Garvey.

[19] No. 13-cv-635 (D.D.C. July 23, 2013), at 17.

The district court first examined plaintiffs' claim that the SEC did not properly analyze the costs and benefits of the rule, in violation of the requirements under the Securities Exchange Act that the SEC consider "whether the action will promote efficiency, competition and capital formation"[20] and ensure that the rule does not "impose a burden on competition not necessary or appropriate in furtherance of the purposes of"[21] the Exchange Act. Plaintiffs alleged that the SEC did not properly analyze the costs and benefits of the rule because it had not independently determined whether the rule was necessary or appropriate to decrease conflict and violence in the DRC. The court disagreed with this charge.

According to the court, the Exchange Act provisions cited by plaintiffs (even if they applied, which is not certain, since Section 1502 of Dodd-Frank did not reference them), did not require the type of analysis that plaintiffs claimed was necessary. Instead, the provisions required only SEC consideration of such matters as promotion of efficiency and not imposing a burden upon competition. "Simply put, there is no statutory support for Plaintiffs' argument that the Commission was required to evaluate whether the Conflict Mineral Rule would actually achieve the social benefits Congress envisioned."[22] Plaintiffs cited D.C. Circuit Court cases[23] as precedent for SEC rule invalidation. The court responded that the cases which plaintiffs cited were based on "shortcomings on the Commission's part with respect to the *economic* implications of its actions—economic implications that the SEC was statutorily required to consider in adopting the challenged rules."[24] In contrast, according to the court, those decisions could not provide support to plaintiffs' argument that the rule must be invalidated because the SEC did not consider whether the rule would actually achieve the humanitarian benefits which Congress identified. In issuing the rule, according to the court, the SEC correctly maintained that its role was not to second-guess Congress but, instead, to issue a rule that would promote the benefits that Congress identified. The court, therefore, seemed to find that, even if compliance with the cost-benefit and competition requirements of the Exchange Act were necessary, the SEC satisfied the second prong requirement of the *Chevron* test that the rule must be a permissible interpretation of the statute.

> Therefore, upon review of the record, the Court is convinced that the Commission appropriately considered the various factors that Sections 3(f) and 23(a)(2) of the Exchange Act actually require. No statutory directive obliged the Commission to reevaluate and independently confirm that the Final Rule would actually achieve the humanitarian benefits Congress intended. Rather, the SEC appropriately deferred to Congress's determination on this issue, and its conclusion was not arbitrary, capricious, or contrary to law—whether because of some statutory directive under the Exchange Act or otherwise.

Plaintiffs also complained that the SEC was incorrect in not providing any type of *de minimis* exception from the rule's coverage. They contended that the SEC wrongly interpreted the statute to mean that it did not have the authority to determine a *de minimis* threshold and that, even if the

[20] Section 3(f) of the Securities Exchange Act, *codified at* 15 U.S.C. §78c(f).

[21] Section 23(a)(2) of the Securities Exchange Act, *codified at* 15 U.S.C. §78w(a)(2).

[22] No. 13-cv-635 (D.D.C. July 23, 2013), at 19-20.

[23] *See e.g.,* Business Roundtable v. Securities and Exchange Commission, 647 F.3d 1144 (D.C. Cir. 2011); American Equity Investment Life Insurance Company v. Securities and Exchange Commission, 613 F.3d 166 (D.C. Cir. 2010); and Chamber of Commerce v. Securities and Exchange Commission, 412 F.3d 133 (D.C. Cir. 2005), all of which to some extent vacated SEC rules because of the Commission's failure to consider the effect of the rule upon efficiency, competition, and capital formation.

[24] *Id.* at 21.

SEC was correct in not providing a *de minimis* exception, its analysis of the issue was arbitrary and not able to survive APA review. Plaintiffs stated that the SEC could have used its general exemptive authority under the Exchange Act, allowing it to "exempt ... any class or classes of persons, securities, or transactions, from any provision or provisions [of the Exchange Act] or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors."[25]

To this argument, the SEC stated that it was well aware of its exemptive authority but that its discretion in interpreting the statute allowed it not to provide a *de minimis* exception. The district court agreed with the SEC that it was correct in exercising its independent judgment in declining to adopt a *de minimis* exception, and the court believed that it could not say that the SEC's determination was unreasonable or without a rational connection in violation of the APA.

Plaintiffs next contested as inconsistent with the statute the part of the rule requiring due diligence and reports when the minerals "did originate" or "may have originated" in the DRC. According to the plaintiffs, the statute required due diligence and reports only when the minerals "did originate" in the DRC. Plaintiffs further stated that, even if the statute were ambiguous, the SEC's interpretation merited no deference because the SEC acted arbitrarily and capriciously. The court replied to this argument that, because the statute did not directly speak to the specific circumstances which trigger disclosure obligations, the SEC appropriately construed the statute as ambiguous (*Chevron* Step One) and interpreted the statute in a reasonable and permissible way (*Chevron* Step Two).

Plaintiffs argued that the SEC's extension of the rule to issuers that only contract to manufacture products with necessary conflict minerals instead of limiting the rule's coverage to issuers that themselves manufacture the products was contrary to the statute and also arbitrary and capricious. The plaintiffs argued that the SEC's interpretation failed *Chevron* Step One because the statute limits its coverage to issuers which manufacture products. The SEC countered that Section 1502 was ambiguous on this point. The court stated that it found no "clear and plain meaning" from the words of the statute and that, because both parties made credible arguments suggests that Congress did not make its meaning plain in the statute. The court went on to point out that the term "manufacture" is inherently ambiguous and that few authorities limit manufacturing only to fabrication. Because the court could not say that the statute was unambiguous, it could not grant plaintiffs' *Chevron* Step One argument. As for plaintiffs' argument that the SEC's rule was arbitrary and capricious, the court stated that the rule's application to issuers that contract to manufacture was a "perfectly permissible construction of Section 1502" and not arbitrary, capricious, or contrary to law.

Plaintiffs' final argument—that the rule violated the APA—challenged the four-year phase-in period for small companies and two-year phase-in period for large companies as arbitrary and capricious. Because some small companies are part of the supply chains of large companies, plaintiffs argued, small companies do not have to provide the information that large companies must report within the two-year phase-in period, resulting in an unreasonable burden upon large companies. The court stated that the plaintiffs' concerns, though not altogether unfounded, were "overinflated" and that it was not unreasonable for the SEC to have a bifurcated phase-in period.

[25] 15 U.S.C. §78mm(a)(1).

### *First Amendment Challenge*

The court went on to analyze the NAM's claims that the portion of the rules that required companies to declare on their websites that certain products were "not found to be DRC conflict free," violated their First Amendment rights.[26] The plaintiffs did not challenge the portion of the rule that required disclosure of this information to the SEC, which may have qualified for a lower standard of review than the public disclosure requirement. The court would ultimately find that the public disclosure requirement comported with the First Amendment.

The court began by discussing the proper standard of review for the rules. The SEC had argued that the rules should be analyzed under the "rational basis" standard which can be applied to certain factual disclosure requirements. Under this standard, "purely factual and uncontroversial' disclosures are permissible if they are 'reasonably related to the State's interest in preventing deception of consumers,' provided the requirements are not 'unjustified or unduly burdensome.'"[27] D.C. Circuit precedent has further indicated that this standard may only be applied to disclosure requirements intended to prevent consumer deception.[28] Because the SEC conceded that the conflict minerals rules were not aimed at preventing consumer deception, the D.C. District Court declined to apply the rational basis standard. Looking to circuit precedent for which standard to apply, the court ultimately decided that, given the commercial context in which the regulations arose, the court would apply the general "intermediate scrutiny" standard applied to commercial speech announced by the Supreme Court in a case commonly known as the *Central Hudson* test.[29]

Under the *Central Hudson* test, in order to survive review a regulation must (1) address a substantial government interest; (2) directly advance that interest; and (3) be narrowly tailored to achieve that interest.[30] Under *Central Hudson*, the narrow tailoring prong is met if there is a reasonable fit between the means chosen and the interest sought to be achieved by the regulation. NAM agreed that the government has a substantial interest in promoting peace in the DRC. However, NAM contended that requiring companies to disclose whether their products were "DRC conflict free" did not directly advance that interest, nor was it a reasonable fit between means and ends.

Specifically, the plaintiffs argued that Congress had provided no hard evidence that public disclosures regarding whether a product is "DRC conflict free" would actually lead to the promotion of peace in the DRC and the regulation, therefore, could not be said to directly advance the government's interest. While the court did agree that the burden of showing that a regulation directly advances a particular interest is not satisfied by mere conjecture, and that the government must demonstrate that the regulation will materially relieve the identified harm, the court also found that there are more types of permissible evidence of direct advancement than empirical evidence, particularly in the context of foreign relations. The court quoted the Supreme Court's finding that in the foreign relations context that "conclusions must often be based on

[26] No. 13-cv-635 (D.D.C. July 23, 2013), at 48.

[27] *Id*. at 52 (quoting R.J. Reynolds Tobacco Co. v. FDA, 696 F.3d 1205, 1212 (D.C. Cir. 2012) (*quoting* Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626, 651 (1985)).

[28] *See* R.J. Reynolds, 696 F.3d at 1214.

[29] No. 13-cv-635 (D.D.C. July 23, 2013), at 55 (*citing* Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 566 (1980).

[30] Cent. Hudson, 447 U.S. at 566.

informed judgment rather than concrete evidence, and that reality affects what we may reasonably insist on from the Government."[31] The court went on to note that Congress specifically found in the statute that the money used to purchase conflict minerals is funding the conflict in the DRC and that Congress could not "begin to solve the problem of eastern Congo without addressing where the armed groups are receiving their funding, mainly from the mining of a number of key conflict minerals."[32] Congress relied on information from the State Department and the United Nations, among other sources, to reach the conclusion that requiring disclosure from companies that use these minerals in their products was a reasonable step toward bringing these issues out in the open. As a result, the court found that Congress's decision to enact this statute was based upon "informed judgment" that the regulation would directly advance its interests.[33]

Turning to the last prong, the plaintiff argued that there were many less restrictive means for the government to achieve its goal. The crux of the plaintiff's argument seemed to hinge upon the fact that the rules compelled companies to state on their web sites that their products had not been found to be DRC conflict free. In the plaintiff's estimation, this requirement amounted to a requirement that companies brand themselves with a 'scarlet letter' of complicity in the atrocities that occur in the DRC. The court did not agree that the rule was so burdensome. The rules would require companies to post their conflict mineral reports on their web sites, and companies were free to do so in whatever manner they chose. They would not have to prominently feature the fact that any of their products were "not found to be DRC conflict free," and could provide any amount of context or extra information that they wished in order to explain their findings. Furthermore, the court found that the *Central Hudson* standard requires only that Congress choose a regulation proportionate to its goals. The regulation need not even be considered by the reviewing court to be the most reasonable option to withstand scrutiny. As a result, the court held that the regulations represented a reasonable fit between the means and the ends, and concluded that the regulations withstood constitutional scrutiny.

## U.S. Court of Appeals Decision

On September 18, 2013, NAM and the other plaintiffs filed an appeal of the D.C. District Court's decision with the U.S. Court of Appeals for the District of Columbia Circuit (D.C. Circuit).[34] On January 7, 2014, a D.C. Circuit panel heard oral argument. On April 14, 2014, a divided D.C. Circuit held that the SEC rule and the statute requiring the rulemaking ran afoul of the First Amendment but disagreed with the plaintiffs' arguments that the SEC violated the APA and the cost-benefit requirements of the Securities Exchange Act.

### *Administrative Procedure Act Challenge*

Before addressing the First Amendment issue, the circuit court considered the APA and Securities Exchange Act challenges that NAM brought. The court stated that it was reviewing the

[31] No. 13-cv-635 (D.D.C. July 23, 2013), at 58 (*quoting* Holder v. Humanitarian Law Project, 561 U.S. 1, 130 S. Ct. 2705, 2727-28 (2010).

[32] *Id*. at 59 (*quoting* 156 Cong. Rec. S3817 (May 17, 2010) (statement of Sen. Durbin)).

[33] *Id*. at 60.

[34] No. 13-5252 (D.C. Cir. April 14, 2014).

"administrative record as if the case had come directly to us without first passing through the district court."[35]

The court first addressed NAM's claim that the SEC rule should have had an exception for *de minimis* uses of conflict minerals and that the SEC erred when it failed to create an exception and assumed that the statute foreclosed it from doing so. The court found that the SEC did not act arbitrarily and capriciously by not including a *de minimis* exception. The court found acceptable the SEC's reasoning that, because conflict minerals may often be used in very limited quantities, a *de minimis* exception might interfere with the intent of Congress in enacting the statute.

The court next addressed the final rule's requirement that an issuer must conduct due diligence if it has reason to believe that conflict minerals may have originated in covered countries. NAM argued that this requirement contravened the statute, which, in NAM's view, required issuers to submit a report to the SEC only in cases in which the conflict minerals actually did originate in the covered countries. In responding to NAM's argument, the court used the *Chevron* reasoning that, if a statute "is silent or ambiguous with respect to the specific issue at hand," the agency has the authority to use reasonable discretion in construing the statute. Here, according to the court, the statute did not mention either a threshold for conducting due diligence or the obligations of uncertain issuers. Nothing in the statute prevented the SEC from filling in those gaps in the statute. Further, according to the court, the manner in which the SEC filled in the gaps was neither arbitrary nor capricious.

In addition, NAM argued that the SEC violated the statute by deciding to apply the rule expansively to issuers that only contract to manufacture products, rather than limiting it to issuers that actually manufacture products. Once again, the court replied that the more reasonable interpretation of the statute is that Congress decided not to mandate the specifics of the rule and left its application to agency discretion and that the SEC did not act arbitrarily or capriciously.

As for the rule's different phase-in periods for large and small companies, which NAM argued were inconsistent, arbitrary, and capricious, the appeals court, like the district court, was able to see the "trickledown" logic of the SEC's approach.[36]

### *Securities Exchange Act Challenge*

As opposed to the district court, which examined the plaintiffs' challenges to the law under the Securities Exchange Act at the beginning of its analysis of plaintiffs' arguments, the appeals court examined the Securities Exchange Act challenges after it had examined the APA challenges. NAM alleged that the SEC rule violated 15 U.S.C. Sections 78w(a)(2) and 78c(f) because it did not adequately analyze the costs and benefits of the final rule. The court found no problem with the Commission's cost-side analysis and stated that it did not understand how the Commission could have done a better job with respect to determining the benefits of the rule. The court went on to emphasize that the statute required the SEC to promulgate a disclosure rule and that it (the SEC) could not second-guess Congress as to the basic premise that a disclosure rule would help to promote peace and stability in the Congo.

[35] *Id*. at 8.

[36] The court stated at 14 that the SEC explained: "Large issuers ... can exert greater leverage to obtain information about their conflict minerals ... , and they may be able to exercise that leverage indirectly on behalf of small issuers in their supply chains."

### *First Amendment Challenge*

Like the district court before it, the court of appeals determined that the regulations requiring public disclosure of the "DRC conflict" status of certain products did not qualify for rational basis review.[37] In deciding that the rational basis standard was not appropriate, the court appeared to question whether the required disclosures were purely factual. The court wrote that "[p]roducts and minerals do not fight conflicts. The label 'conflict free' is a metaphor that conveys moral responsibility for the Congo war.... By compelling an issuer to confess blood on his hands, the statute interferes with the exercise of the freedom of speech under the First Amendment."[38] Despite questioning whether the required disclosures were factual, the court ultimately did not decide that issue. Instead, the court refused to apply a rational basis standard because the disclosures were not required for the purpose of alleviating consumer deception. This reason was similar to the district court's analysis. Unlike the district court, the appeals court did not determine which of the remaining standards of scrutiny (i.e., intermediate or strict scrutiny) properly applied to the regulations, because the court found that the regulations did not even survive intermediate scrutiny under the *Central Hudson* test.

After laying out the basic elements of the test, the court explained its view that "the narrow tailoring requirement invalidates regulation for which 'narrower restrictions on expression would serve [the government's] interest as well.'"[39] Though acknowledging that the government need only show a reasonable fit between the means and ends of a regulation, the court found that "the government cannot satisfy that standard if it presents no evidence that less restrictive means would fail."[40] The association challenging the rules had made a number of suggestions that it believed would be less restrictive than the rules adopted by the SEC, including that the companies could be required to describe their products' status in their own words. Given the other options the SEC had for implementing the disclosure requirement and the fact that the Commission "failed to explain why (much less provide evidence that) the Association's intuitive alternatives to regulating speech would be any less effective," the court found that the rules were not narrowly tailored and therefore violated the First Amendment.[41]

The dissent in the case would have held the decision on the First Amendment question in abeyance until the full court of appeals, sitting *en banc*, had decided the question of whether a rational basis standard could be applied to disclosure requirements outside of the consumer deception context. [42] If an *en banc* court decides that it can, this issue may need to be reconsidered by this panel at that time.

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[37] National Ass'n of Manufacturers v. SEC, No. 1:13-cv-00635 (D.C. Cir. Apr. 14, 2014), at 21.

[38] *Id*. at 20.

[39] *Id*. at 21. (internal citations omitted)

[40] *Id*. at 21-22. Interestingly, for this principle that the government must present evidence that less restrictive means would fail in the context of applying intermediate scrutiny, the court cites Sable Comm'n v. FCC, 492 U.S. 115, 128-32 (1989). In *Sable*, the Supreme Court applied strict scrutiny to a regulation which prohibited certain indecent telephone services. Indecent speech, when not delivered over the broadcast airwaves, is fully protected speech. *Id*. at 126. Regulations of fully protected speech are subject to strict scrutiny, a higher standard than the court of appeals was applying here. *Id*. Under strict scrutiny, it is clear that the government may only apply regulations that are the least restrictive means of achieving its compelling interests. It is unclear whether the court, in this case, applied an analytical element of a higher standard of scrutiny in the context of applying a lower standard of scrutiny.

[41] No. 1:13-cv-00635 (D.C. Cir. Apr. 14, 2014), at 22.

[42] *Id*. (Srinivasan, J. dissenting).

### *Petition to Hold Appellate Decision in* NAM v. SEC *in Abeyance for Potential Rehearing*

On May 29, 2014, the SEC and Amnesty International (as intervenor) petitioned the D.C. Circuit to hold *NAM v. SEC* in abeyance for possible rehearing by the panel or rehearing *en banc*.[43] The SEC, adopting the argument made by the dissent in the appellate decision, argued that because another case, captioned *American Meat Institute v. Department of Agriculture*,[44] that is pending before the *en banc* D.C. Circuit Court of Appeals might have an effect on the outcome of *NAM v. SEC*, the court should hold the case until it reaches a decision in *American Meat Institute*. The SEC further argued that because the SEC has stayed the application of the portion of the rules struck down by the appellate panel until a final decision is reached, no First Amendment harm would result from holding the opinion in abeyance.

In *American Meat Institute*, the D.C. Circuit is being asked to decide whether the government can require meat producers to disclose the point of origin of their products.[45] Both the district court and the appellate panel upheld the rules against a First Amendment challenge from the meat packing industry.[46] The primary legal question presented by the case, much like one of the questions presented in *NAM v. SEC*, is whether disclosure requirements imposed for reasons other than the prevention of consumer deception qualify for a lower standard of scrutiny. The decision in *American Meat Institute* could effectively lower the standard of review the court should apply to the SEC's conflict mineral disclosure rules from an intermediate standard to a rational basis standard. If the standard is lowered to a rational basis standard, the SEC's disclosure rule would be more likely to survive a constitutional challenge and the appellate panel decision striking the rule down could be overturned. On the other hand, if the D.C. Circuit holds that the lower standard can only be applied in the more narrow circumstance of preventing consumer deception, these cases may create a split between the circuit courts of appeal regarding when the rational basis standard may be applied to disclosure requirements. Other circuit courts of appeal have held that the rational basis standard applies more broadly than only to the prevention of deception.[47] If the D.C. Circuit holds otherwise, the difference in application of the standard may eventually need to be resolved by the Supreme Court.

The D.C. Circuit heard oral argument in the *American Meat Institute* case on May 19, 2014, but, as of the date of this report, has not yet issued its decision in the case.[48] Likewise, the court of appeals has yet to decide whether to grant the SEC's petition for a stay pending the outcome of that case, as of the date of this report.

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[43] Pet. of the SEC for Rehearing or Rehearing *En Banc* Pending Decision in American Meat Institute v. Department of Agriculture, No. 13-5281 (D.C. Cir.) *en banc*, NAM v. SEC, No 13-5252 (D.C. Cir. 2014), available at http://www2.bloomberglaw.com/public/desktop/document/Natl_Assoc_of_Manufacturers_et_al_v_SEC_et_al_Docket_No_1305252_D/13.

[44] No. 13-5281 (D.C. Cir.) *en banc*.

[45] *Id*.

[46] No. 13-5281 (D.C. Cir. 2014), available at http://www.cadc.uscourts.gov/internet/opinions.nsf/0A414DC69DA6F05585257CA9004D8645/$file/13-5281-1485877.pdf.

[47] See Pharm. Care Mgmt. Ass'n v. Rowe, 429 F.3d 294, 298-99, 308-10 (1st Cir. 2005); Nat'l Elec. Mfrs. Ass'n v. Sorrell, 272 F.3d 104, 107 n.1 (2d Cir. 2001).

[48] Erica Teichert, Meat Industry Urges DC Circ. To Nix Tough Labeling Rules (May 19, 2014) http://www.law360.com/articles/539265/meat-industry-urges-dc-circ-to-nix-tough-labeling-rules.

### SEC Guidance on Filing Conflict Minerals Disclosure Forms

In light of the decision by the court of appeals, on April 29, 2014, the SEC issued guidance on what covered companies must file with respect to the disclosures required by the conflict minerals rule.[49] The Commission expects companies to file reports on or before the due date, June 2, 2014, and address those parts of the rule that the court upheld. Specifically, the Division of Corporate Finance stated,

> [C]ompanies that do not need to file a Conflict Minerals Report should disclose their reasonable country of origin inquiry and briefly describe the inquiry they undertook. For those companies that are required to file a Conflict Minerals Report, the report should include a description of the due diligence that the company undertook. If the company has products that fall within the scope of Items 1.01(c)(2) or 1.01(c)(2)(i) of Form SD, it would not have to identify the products as "DRC conflict undeterminable" or "not found to be 'DRC conflict free,'" but should disclose, for those products, the facilities used to produce the conflict minerals, the country of origin of the minerals and the efforts to determine the mine or location of origin.[50]

# Section 1504 of Dodd-Frank

## Statute

Section 1504 of Dodd-Frank, codified at 15 U.S.C. Section 78m(q), requires resource extraction issuers[51] to disclose to the Commission payments made to a foreign government or federal government for the purpose of the commercial development of oil, natural gas, or minerals. The resource extraction issuer, a subsidiary of the issuer, or an entity under the control of the issuer must include this information in an annual report filed with the SEC. Information to be disclosed shall include the type and total amount of the payments made for each project of the resource extraction issuer concerning the commercial development of oil, natural gas, or minerals and the type and total amount of the payments made to each government. The statute mandates that the rules, to the extent practicable, shall support the commitment of the United States to international transparency promotion efforts concerning the commercial development of oil, natural gas, or minerals. The Commission must, to the extent practicable, make a compilation of the information available online to the public.

[49] http://www.sec.gov/News?publicStmt/Detail/PublicStmt/1370541681994#.

[50] *Id.*

[51] "[T]he term 'resource extraction issuer' means an issuer that—

(i) is required to file an annual report with the Commission; and

(ii) engages in the commercial development of oil, natural gas, or minerals. Dodd-Frank, §1504, specific provision codified at 15 U.S.C. §78m(q)(1)(D).

## Regulations[52]

On August 22, 2012, the SEC issued final rules (later challenged and vacated by a court decision discussed in the following section) to implement Section 1504.[53] 17 C.F.R. Section 240.13q-1 required every resource extraction issuer engaged in the commercial development of oil, natural gas, or minerals to file a report on Form SD[54] within the period specified in the form and to disclose the information specified by the form. "Commercial development of oil, natural gas, or minerals includes exploration, extraction, processing, and export of oil, natural gas, or minerals, or the acquisition of a license for any such activity."[55] The rule required that the reports be made publicly available.

## Legal Challenge

In October 2012, the American Petroleum Institute, the U.S. Chamber of Commerce, the Independent Petroleum Association of America, and the National Foreign Trade Council filed suit against the SEC. Plaintiffs challenged the SEC rule on the basis that it violated the First Amendment guarantee of freedom of speech, that it was arbitrary and capricious under the APA, and that the SEC, as with Section 1502, had made an inadequate cost-benefit analysis before promulgating the rule. With respect to the First Amendment challenge, the plaintiffs alleged that, because the SEC rule required disclosures that would arguably allow business competitors access to sensitive commercial information, they would be compelled to engage in speech that would have "disastrous effects on the companies, their employees, and their shareholders" in violation of their First Amendment rights. With respect to the inadequate cost-benefit analysis challenge, the plaintiffs alleged that the SEC violated its statutory duty under Section 23(a)(2) of the Securities Exchange Act[56] to consider the public interest and refrain from adopting a rule that would impose a burden upon competition. Oxfam International, an international human rights organization, was granted permission to intervene in the case in support of the rules.[57]

### Federal District Court Decision

The case, *American Petroleum Institute v. Securities and Exchange Commission,*[58] was decided on July 2, 2013, by the U.S. District Court for the District of Columbia.

The court ruled in favor of the plaintiffs and granted the plaintiffs' motion for summary judgment, vacated the rule, and remanded the rule to the SEC for further proceedings. The court did not

[52] The regulations are not in effect because they were vacated by the court decision discussed in the following section, "Legal Challenge."

[53] 17 C.F.R. §§240.13q-1 and 248.

[54] A copy of Form SD may be found at http://www.sec.gov/about/forms/formsd.pdf.

[55] 17 C.F.R. §240.13q-1(a)(b)(2).

[56] *See* footnote 8 above.

[57] "Transparency in the oil, gas and mining industry is now a global norm," said Gary [Ian Gary, senior policy manager of Oxfam America's oil, gas and mining program]. Oil companies should join citizens in resource-rich countries, investors, and energy consumers in supporting disclosure rather than seeking to turn back the tide through litigation and threaten global progress toward reducing corruption in resource-rich countries." http://www.oxfamamerica.org/press/oxfam-calls-on-exxon-shell-bp-and-chevron-to-withdraw-support-from-oil-industry-lawsuit-get-on-transparency-train/.

[58] Civil Action No. 12-1668 (JDB) (D.D.C. July 2, 2013).

reach the plaintiffs' First Amendment challenge or most of their Administrative Procedure Act arguments "because [it determined that] two substantial errors require[d] vacatur: the Commission misread the statute to mandate public disclosure of the reports, and its decision to deny any exemption was, given the limited explanation provided, arbitrary and capricious."[59]

In its analysis of the validity of the rule, the court applied "*Chevron*'s well-worn framework."[60] As described before, the court first must ask whether Congress directly spoke to the precise question at issue and, if Congress has done so, an agency must in its rule adhere to the unambiguously expressed intent of Congress. If the statute is silent or ambiguous concerning the specific issue, a court moves to the second step and must defer to an agency's interpretation of the statute so long as the interpretation is "based on a permissible construction of the statute." The court went on to quote from a D.C. Circuit case that "deference is only appropriate when the agency has exercised its *own* judgment."[61] If the agency's rule is based on an inaccurate interpretation of the law, its rule cannot stand.

The first basis upon which the court vacated the SEC rule concerned the SEC's requirement that the reports be made publicly available. The court stated that the SEC clearly believed that it was bound to make the annual reports publicly available. With this decision, the Commission stopped its *Chevron* analysis at Step One and believed that it did not have discretion to reach another result. The district court concluded that, therefore, no deference to the SEC's statutory interpretation is warranted because the SEC did not exercise its own judgment; rather, it believed that the interpretation was compelled by Congress. The court then faced the task of determining whether the statute compelled the public disclosure of full payment information, or in *Chevron* terms, "whether Congress has directly spoken to the precise question at issue."

The court found that the SEC wrongly concluded that Section 1504 of Dodd-Frank required reports of resource extraction issuers to be made publicly available and cited the language in the statute requiring the SEC to make public only a "compilation of the information required to be submitted" to the SEC "to the extent practicable." The statute required the disclosure of annual reports but did not indicate whether the disclosures must be public or whether they may be made only to the SEC. The statute also expressly addressed the public availability of the information and established a more limited requirement for what must be made publicly available than, for example, what must be made publicly available in an annual report. According to the court, the SEC offered no persuasive arguments that the statute unambiguously required that the full reports be publicly disclosed.

The court stated,

> The Commission did not indicate in the Rule the form that a compilation would take, opting instead to assure public availability by requiring public filing of the annual reports themselves. Nonetheless, the Commission's briefs confirm that it misinterprets the word "compilation."

With this statement, the court concluded that the agency's remaining arguments for mandating public disclosure of the annual reports derived from this error. The court went into a lengthy

[59] *Id.* at 7.

[60] *See* discussion of *Chevron* above at p. 4.

[61] Transitional Hosps. Corp. v. Shalala, 222 F.3d 1019, 1024 (D.C. Cir. 2000).

discussion of the meaning of "compilation of information," looking at such sources as judicial opinions and Shakespeare's sonnets, and found that the term can have a wide variety of meanings and a combination of elements. After this discussion, the court stated that the Commission was not required by the statute to make all of the information available on an annual basis but, rather, a "significant responsibility" to evaluate the information to determine whether disclosing it in a compilation is practicable and then use the information to make a compilation.

The court then turned to intervenor Oxfam's arguments in support of the rule and found them similarly unpersuasive. For example, Oxfam argued that Congress intended public disclosure when it inserted Section 1504 of Dodd-Frank into Section 13 of the Securities Exchange Act, which created the public reporting requirements for filing issuers. The court refuted this argument by stating that the Securities Exchange Act does not define a report as something that must be publicly filed and does not preclude the confidential treatment of reports that are filed. The court also disagreed with Oxfam's argument that the SEC's decision was reasonable and reiterated "black letter law" that an agency's regulation has to be declared invalid if the regulation was not based upon the agency's own judgment but, instead, upon the unjustified assumption that Congress indicated that such a regulation was desirable or required.

The second basis upon which the court vacated the SEC rule concerned the SEC's rejection of any exemption where disclosure is prohibited. The court found that the denial of any exemption for countries in which resource extraction payment disclosures are prohibited was arbitrary and capricious. According to the court, commentators expressed concern that, because Angola, Cameroon, China, and Qatar prohibit disclosure of payment information, there could be added billions of dollars to issuers dealing in resource extraction that would have a significant impact upon their profitability and ability to compete. The court found these concerns warranted, but the SEC argued that, although it understood the concerns, adopting an exemption would be "inconsistent with the structure and language" of the statute.

The Securities Exchange Act provided the SEC with the authority to make exemptions from some of its provisions, including the section in which the resource extraction provision is codified. Although the exemption authority is discretionary, exercising it could, according to the court, be required in some circumstances by the SEC's competing statutory obligations, such as the requirement that the SEC" shall not adopt any ... rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of this chapter."[62] In addition, the court stated, an agency decision concerning exemptions must be based upon reasoned decision-making. With these principles in mind, the court rejected the SEC's reasoning for not providing an exemption from the disclosure requirements, stating,

> The Commission's primary reason for rejecting an exemption does not hold water. The Commission argues that an exemption would be "inconsistent" with the "structure and language of Section 13(q).... " But this argument ignores the meaning of "exemption," which, by definition, is an exclusion or relief from an obligation, and hence will be inconsistent with the statutory requirement on which it operates. Nor does it help to argue that section 13(q)'s transparency objectives "are best served" by permitting no exemptions.... That an exemption is inconsistent with a statutory provision or that the provision's purpose is "best" served by allowing no exemptions is hence no answer at all.

[62] 15 U.S.C. §78w(a)(2).

As for the SEC's second explanation—that an exemption might undermine the statute by encouraging countries to adopt laws that would prohibit the disclosure required by the rule—the court stated that a court will typically not permit any of the rationales used by an agency when one of the multiple rationales that an agency has relied upon is deficient. The SEC could have limited the exemption to the four countries that the commentators cited, for example, in order to address this concern. Because the agency did not provide an exemption of this limited type but, instead, focused on what it believed to be the statute's apparent purpose, it showed itself averse to sacrificing any of the statute's aims despite the cost, thereby "abdicating its statutory responsibility to investors."[63] The court therefore concluded that the SEC's exemption analysis was arbitrary and capricious and invalidated the rule.

The SEC has stated that it will not appeal the case and will, instead, "undertake further proceedings" concerning issuing another rule that is in keeping with the court's decision.[64] The SEC has not yet issued a new rule. As a result of the SEC's inaction, Oxfam America has filed a lawsuit against the SEC in the U.S. District Court for the District of Massachusetts over the agency's delay in issuing a new resource extraction disclosure rule.[65]

# Conclusion

The SEC's rules implementing Sections 1502 and 1504 of Dodd-Frank have clearly been controversial. The D.C. District Court upheld the rules for Section 1502, but, although it upheld the bulk of the rules and the SEC's administrative authority to promulgate them, the D.C. Circuit struck down as a violation of the First Amendment the part of the rules requiring issuers to describe certain products as having been "not found to be DRC conflict free." The SEC has petitioned for a rehearing pending the D.C. Circuit's decision in *American Meat Institute v. Dept. of Agriculture*. The decision in *American Meat Institute* could effectively lower the standard of review the court should apply to the SEC's conflict mineral disclosure rule from an intermediate standard to a rational basis standard, making the SEC's rule more likely to be upheld upon review.

Taken together, *American Meat Institute* and *NAM v. SEC* may affect the degree to which the government can require disclosures from companies in many different contexts and, depending upon the outcome, the cases could create a split among the circuit courts of appeal that may eventually need to be resolved by the Supreme Court.

With respect to the Section 1504 rules, the D.C. District Court vacated the rules. The SEC has decided not to appeal the decision but, instead, to work on rules which will meet the court's objections.

The final outcome concerning rules for both Sections 1502 and 1504 of Dodd-Frank is, therefore, unknown, as of the date of this report.

[63] *Id.* at 27.

[64] http://www.financialexecutives.org/KenticoCMS/FEI_Blogs/Financial-Reporting-Blog/September-2013/SEC-To-Undertake-Further-Work-on-Resource-Extracti.aspx#axzz35mmNLjlD.

[65] Oxfam America, Inc. v. Securities and Exchange Commission, No. 14-cv-13648 (D. Mass. Sept. 18, 2014).

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