Simpson Thacher

Memorandum

SEC's Acting Chairman and Division of Corporation Finance Issue Updated Statements on Conflict Minerals Rule

April 10, 2017

On April 3, 2017, the United States District Court for the District of Columbia entered a final judgment in the litigation challenging the Dodd-Frank mandated rule of the Securities and Exchange Commission ("SEC") that requires public companies to investigate and disclose the origin of certain minerals ("conflict minerals") found in the Democratic Republic of the Congo ("DRC") and countries bordering the DRC.[1] In accordance with the 2014 decision of the United States Court of Appeals for the District of Columbia Circuit, the district court declared that the SEC's conflict minerals rule and the statutory provision on which it is based "violate the First Amendment to the extent that the Statute and the Rule require regulated entities to report to the Commission and to state on their websites that any of their products have not been found to be 'DRC conflict free.'"[2] The court thus held "unlawful and set[] aside" the conflict minerals rule, "only to the extent that it requires regulated entities" to disclose "that any of their products have not been found to be 'DRC conflict free,'" and remanded the rule to the SEC.

The SEC's Division of Corporation Finance and Acting Chairman Michael S. Piwowar each issued a statement on April 7 regarding the recent judgment.[3] Acting Chairman Piwowar noted that the Court of Appeals had left open the question of whether describing an issuer's products as "not DRC conflict free" is "required by statute or, rather, is solely a product of the Commission's rulemaking." Thus, explained Acting

[1] *See Nat'l Ass'n of Mfrs., et al.* v. *SEC*, No. 13-CF-000635 (D.D.C. Apr. 3, 2017).

[2] *Id.* (internal quotations omitted). For a discussion of the 2014 decision of the Court of Appeals for the District of Columbia Circuit, *see* Simpson Thacher & Bartlett LLP, "Court of Appeals Invalidates Part of SEC's Conflict Minerals Rule; SEC to Implement the Remainder of the Rule" (Apr. 30, 2014).

[3] *See* SEC Division of Corporation Finance, "Updated Statement on the Effect of the Court of Appeals Decision on the Conflict Minerals Rule" (Apr. 7, 2017); Acting Chairman Michael S. Piwowar, "Statement of Acting Chairman Piwowar on the Court of Appeals Decision on the Conflict Minerals Rule" (Apr. 7, 2017).

Chairman Piwowar, the SEC must now "determine how to address the Court of Appeals decision – including whether Congress's intent . . . can be achieved through a descriptor that avoids the constitutional defect identified by the court – and how that determination affects overall implementation of the Conflict Minerals rule." Accordingly, Acting Chairman Piwowar has instructed the SEC staff "to begin work on a recommendation for future Commission action," taking into account, among other things, comments received in response to his January 31, 2017 request for comment on the conflict minerals rule and the SEC's 2014 guidance that issuers must comply with those aspects of the rule that were upheld by the Court of Appeals.[4]

Significantly, the SEC's Division of Corporation Finance added that, given the uncertainty regarding how the SEC will resolve the issues presented by the district court's remand and the related issues raised by commenters, the Division of Corporation Finance has determined that ***it will not recommend enforcement action*** to the SEC if companies only file disclosure on Form SD under the provisions of the rule requiring a reasonable country of origin inquiry. This enforcement position applies equally to those issuers that are required, under the rule, to conduct due diligence on the source and chain of custody of their conflict minerals. Seemingly providing the rationale for the Division's determination, Acting Chairman Piwowar explained that "[t]he primary function of the extensive and costly requirements for due diligence on the source and chain of custody of conflict minerals . . . is to enable companies to make the disclosure found to be unconstitutional. In light of the foregoing regulatory uncertainties, until these issues are resolved, it is difficult to conceive of a circumstance that would counsel in favor of enforcing" the rule's requirement to conduct due diligence on the source and chain of custody of conflict minerals used in an issuer's products.

The Division of Corporation Finance concluded that its statement is subject to further SEC action, "expresses the Division's position on enforcement action only, and does not express any legal conclusions on the rule." The Division invited issuers with questions about conflict minerals rule compliance to contact the Division.

Implications of the Updated Statements on the Conflict Minerals Rule

The recent statements from the SEC's Division of Corporation Finance and Acting Chairman Piwowar do not conclusively resolve the legal questions relating to the scope of the conflict minerals disclosure requirement. In addition, these statements do not amend the conflict minerals rule itself and are not controlling on the courts – they only address the Division of Corporation Finance's current enforcement position. The adopting release for the conflict minerals rule also provides that Form SD is considered to be "filed" under the Securities and Exchange Act of 1934, as amended (the "Exchange Act") and thereby subject to potential liability under Section 18 of the Exchange Act. Nonetheless, the Division's newly announced enforcement

[4] For more information regarding Acting Chairman Piwowar's request for comment on the conflict minerals rule, *see* Simpson Thacher & Bartlett LLP, "SEC Acting Chairman Piwowar Announces Reconsideration of Conflict Minerals and Pay Ratio Rules" (Feb. 8, 2017).

position suggests that issuers who know or have reason to believe that any of their necessary conflict minerals originated in the DRC or an adjoining country and are not from recycled or scrap sources no longer need to conduct a due diligence review or an audit for purposes of their Form SD disclosure. In assessing what information to include in their Form SD disclosure, issuers, particularly consumer-facing companies, should also consider the potential concerns from investors, consumers and other interest groups.

If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at +1-212-455-3815 or yafit.cohn@stblaw.com, **Arjun Koshal** at +1-212-455-3379 or akoshal@stblaw.com, or any other member of the Firm's Public Company Advisory Practice.

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