Securities Regulation Daily Wrap Up,DODD-FRANK ACT—D.C. Cir.: Conflict minerals decision remains in place over vigorous dissent,(Aug. 18, 2015)

By Mark S. Nelson, J.D.

A two-judge majority of a D.C. Circuit panel has upheld its original decision finding the SEC's conflict minerals rule violated the First Amendment. That decision found the Dodd-Frank Act provision and the agency's implementing rule unconstitutional to the extent they 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.'" Judge Srinivasan issued a lengthy dissent objecting to the majority's choosing to follow its prior decision (*National Association of Manufacturers v. SEC*, August 18, 2015, Randolph, A.).

Today's new panel opinion is the result of the SEC's and intervenor Amnesty International USA's requests for panel rehearing. A separate request for en banc rehearing was initially deferred, but has now been rendered moot and a new period for en banc rehearing will begin now that the panel has issued its latest opinion.

Congressional mandate. Dodd-Frank Act Section 1502 created a disclosure regime by which companies whose products use conflict minerals must undertake certain inquiries that can result in public disclosures about their minerals supply chains on new Form SD or in a conflict minerals report. The sense of Congress recited in Section 1502 said the provision would bring transparency to the use of minerals to fund conflict waged by armed groups in the Democratic Republic of the Congo (DRC) and adjoining countries, which contributes to a humanitarian emergency typified by sexual and gender-based violence.

The D.C. circuit panel in the conflict minerals case had previously upheld the SEC's implementing regulatory framework against Administrative Procedures Act and economic analysis challenges. But the court reiterated today the potential financial costs

of compliance, which it noted range from $3 to $4 billion initially, and $207 to $609 million annually. The panel's concerns focused on the First Amendment overtones to the SEC's rule.

The conflict minerals rule is perhaps the best known example of congressional mandates telling regulators to direct companies to make non-financial securities disclosures. While this trend toward humanitarian or social disclosures is not entirely new, it may continue in some form even after the constitutionality of the conflict minerals rule is settled. Recently, bills introduced in both the House and Senate (H.R. 3226 and S. 1968) would amend the Exchange Act to require companies to disclose if their supply chains involve labor that may be the product of human rights abuses.

***Zauderer* inapt, alternative ground.** Judge Randolph began the majority's analysis by noting that the SEC had acknowledged the use of *Zauderer* in this case after the full D.C. Circuit's *AMI* decision extending *Zauderer* beyond consumer deception is an open question, and that the National Association of Manufacturers or NAM outright urged against using *Zauderer*. As a result, the court had to first grapple with a sub-issue: Does *Zauderer* reach compelled speech not tied to advertising or point-of-sale product labels? The majority answered: "No."

The majority said the Supreme Court explicitly limited *Zauderer* to the advertising context, and even noted that the high court referred to advertising 13 times in *Zauderer*. That left the panel majority where it left off over a year ago when it held *Zauderer* was inapt and, without deciding if strict scrutiny or the intermediate standard in *Central Hudson* applied, reasoned that the conflict minerals rule still would flunk *Central Hudson* 's narrow tailoring prong.

Today the majority went a step further than its April 2014 decision and offered a new rationale to clarify its prior holding in light of the "flux and uncertainty" inherent in the Supreme Court's commercial speech doctrine. The majority said it still would find the Dodd-Frank act provision and the SEC's rule run afoul of the First Amendment even if the conflict minerals disclosures are commercial speech and the *AMI* understanding of *Zauderer* applies.

The majority noted that the SEC's interest in lessening conflict in the DRC was enough for step one of *AMI* and *Central Hudson*. But the SEC's failure to make any showing regarding the effectiveness of the conflict minerals rule in achieving its goals left the law and the rule open to a degree of conjecture not allowed under the First Amendment. The majority pointed to the SEC's reliance on legislative history and a United Nations resolution, plus the high financial costs of compliance. "This in itself dooms the statute and the SEC's regulation," the court would say later in its opinion.

Moreover, the majority rejected intervenor Amnesty International's argument that *AMI* was unclear about the role of *Zauderer*'s lone mention of "purely factual and uncontroversial" information about the good or service being offered. Amnesty International had urged the panel to adopt the view that *Zauderer* merely described the disclosure at issue there instead of setting a legal standard to be applied in future cases. But the majority noted the phrase can still be troubling in practice.

The majority also took issue with the SEC's late-stage mention of the Supreme Court's 1987 opinion in *Meese v. Keene*, which upheld disclosures about films deemed to be political propaganda. The majority said the SEC incorrectly labeled *Meese* a compelled speech case. Here, citing NAM's briefs, the majority highlighted the concern that unfettered definitions in this context could allow the government to demand that companies use its "preferred language."

The majority also reprised its observation in its original conflict minerals opinion that whether a product is "conflict free" or not is "hardly 'factual and non-ideological.'" In essence, the conflict minerals rule requires a company "to confess blood on its hands" in violation of the First Amendment.

Garden variety disclosure. Judge Srinivasan began his 29-page dissent with the proposition that the SEC's conflict minerals rule is akin to the myriad "garden variety" disclosures required under the securities laws and which finds support in the full D.C. Circuit's *AMI* decision. "It is hard to see what is altogether different about another species of 'geographical origin' law requiring identification of products whose minerals come from the DRC or adjoining countries," said Judge Srinivasan.

According to Judge Srinivasan, the "permissive" *Zauderer* test should apply here with the result being to uphold the SEC's rule. Judge Srinivasan went on to say that even if *Central Hudson* applied, he would still uphold the SEC's conflict minerals rule. For Judge Srinivasan, there is little constitutional difference between the requirement to identify and list affected products, which NAM did not object to, and the "catchphrase" disclosure it does challenge for products that have "not been found to be 'DRC conflict free.'"

Judge Srinivasan would have had the panel follow more traditional First Amendment principles under which commercial and non-commercial speech are treated differently, and commercial speech is given varying treatment depending on whether it restricts the flow of truthful information (*Central Hudson*) or expands the flow of truthful information (*Zauderer*).

Judge Srinivasan said he sees the conflict minerals rule falling squarely on the commercial speech side of the ledger. Specifically, he would apply *Zauderer* because the SEC's rule involves compelled speech, albeit to help investors make the choice whether to invest in a particular company's securities based on the company's conflict minerals supply chain practices. He criticized the majority for limiting *Zauderer* to the advertising context, something he said the Supreme Court likely did not plan to do no matter how many times it mentioned advertising in *Zauderer*.

The dissent also explored what *Zauderer* and its progeny mean by "purely factual and uncontroversial" disclosures, something he said the full D.C. circuit in *AMI* did not do because the parties there never seriously disputed that *Zauderer* applied. Judge Srinivasan would read *Zauderer* in context rather than as if it were a statute, which leads him to conclude that "factual" means non-deceptive and also not conjuring a subjective opinion (*i.e.*, the government cannot say what is orthodox in politics, nationalism, religion, or matters of opinion). He also said "uncontroversial" means indisputable " accuracy."

As a result, Judge Srinivasan would apply *Zauderer* to disclosures that are "purely factual" and "accurate." He said this would best achieve *Zauderer*'s goal of getting

useful information about products or services to consumers. Moreover, the judge found support for his view of *Zauderer* in the Supreme Court's 2010 *Milavetz* opinion, which applied *Zauderer* in the context of the then-new bankruptcy reform law.

Even before launching into its analysis, the two-judge majority took time to deal with Judge Srinivasan's dissent. According to the majority, Judge Srinivasan missed the point the majority tried to make because he relied too much on the premise that the SEC already demands many types of disclosures that are uncontroversial without fully acknowledging that the conflict minerals rule seeks to advance humanitarian goals instead consumer protection ones.

The majority would later take another swipe at the dissent. There, the majority said Judge Srinivasan misconstrued the *AMI* court's explanation of what it means for a disclosure to be "purely factual and uncontroversial." Specifically, the majority challenged Judge Srinivasan's assertion that*Zauderer* applies to purely factual and accurate information about a product or service.

Getting to today's ruling. In April 2014, the same panel that ruled today cast aside the SEC's conflict minerals disclosure requirement that would have required some issuers to state in their SEC filings and on their websites that their products "have not been found to be DRC conflict free" because the Dodd-Frank Act and the SEC's implementing rule violated the First Amendment.

Specifically, the conflict minerals panel said the law and the SEC's rule ran afoul of the Supreme Court's *Central Hudson* narrow tailoring prong without deciding if the court must apply strict scrutiny or the *Central Hudson* commercial speech test. Judge Srinivasan had urged the panel to hold off deciding the case against the SEC pending the outcome of a similar challenge to the U.S. Department of Agriculture's country of-origin labeling or COOL rule, which then was before the full D.C. Circuit. The SEC's Division of Corporation Finance issued guidance following the original conflict minerals panel decision.

The en banc D.C. Circuit's July 2014 *AMI* opinion held that *Zauderer* can apply beyond consumer protection to include the types of interests at stake under the USDA's COOL

rule. The main opinion began with the premise that the Supreme Court's language in *Zauderer* is unclear, so that case may apply outside the consumer deception setting. The en banc court also noted the Supreme Court's intermediate scrutiny test in *Central Hudson* is "elusive," but the interests in *AMI* were substantial, so the full court did not decide if lesser interests could satisfy *Zauderer*.

Specifically, the *AMI* majority held: "To the extent that other cases in this circuit may be read as holding to the contrary and limiting *Zauderer* to cases in which the government points to an interest in correcting deception, we now overrule them." That same paragraph cited three prior D.C. Circuit opinions, including the conflict minerals case against the SEC.

AMI seemingly created a new category of commercial speech that lives somewhere between*Zauderer* and *Central Hudson*. It also is a case riddled with inconsistencies stemming from its thin administrative record, a byproduct of the government's inability to whole heartedly defend the possibly protectionist aspects of the COOL rules lest the World Trade Organization sanction the U.S.

Several judges concurred to clarify their understanding of the *AMI* decision or to distance themselves from certain aspects of it. Judge Brown issued a scathing 34-page dissent taking the majority to task for having weakened First Amendment protections.

The D.C. Circuit would later defer en banc rehearing in the conflict minerals case pending the rehearing granted by the original conflict minerals panel. But to help sharpen its review, the panel had asked the SEC, intervenor Amnesty International, and NAM to answer three questions about*AMI*:

- Question 1—What effect, if any, does this court's ruling in *AMI* have on the First Amendment issue in this case regarding the conflict mineral disclosure requirement?
- Question 2—What is the meaning of "purely factual and uncontroversial information" as used in *Zauderer* and *AMI*?

- Question 3—Is determination of what is "uncontroversial information" a question of fact?

How the conflict minerals case proceeds now will depend on whether any of the parties renew their call for the full appeals court to decide the matter or if one or more parties decide to take the case to the Supreme Court. As for the Supreme Court, Justice Thomas invited a future review of *Zauderer*'s place in the commercial speech constellation in his separate opinion in *Milavetz* five years ago.

The case is No. 13-5252.

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Companies: National Association of Manufacturers; Chamber of Commerce of the United States of America; Business Roundtable; Amnesty International USA; Amnesty International Limited

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