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SEC's Toned-Down Conflict Mineral Rule Still Faces A Fight

By **Ian Thoms**

Law360, New York (August 22, 2012, 5:47 PM ET) -- Before adopting long-awaited reporting requirements for companies using so-called conflict minerals Wednesday, the U.S. Securities and Exchange Commission tried to reduce and justify the significant costs associated with the new rule, but experts don't expect the agency's efforts to dissuade business groups from lodging a legal challenge.

The new rule, passed by a 3-2 vote, requires public companies to report to the SEC each year whether they use minerals that directly or indirectly fund violence in the Democratic Republic of the Congo, where millions have been killed, and the efforts taken by the companies to determine the origin of the minerals they use. First reports are due May 31, 2014.

Conflict minerals — tantalum, tin, gold or tungsten — are commonly used in cellphones, laptops and electronic devices, as well as appliances, tin cans, light bulbs and other products, and became one of the targets of the Dodd–Frank Wall Street Reform and Consumer Protection Act.

“This one has been controversial since day one. Cleary, it’s not a core part of Dodd-Frank, most of which deals with the banking and financial services industry,” said Michael Littenberg, a partner at Schulte Roth & Zabel LLP. “It has always been kind of an odd duck within Dodd-Frank.”

The conflict mineral rule has also been considered exceedingly expensive. SEC staffers estimate public companies will spend $3 billion to $4 billion creating programs to comply with the new rule, and then devote another $206 million to $609 million to annual compliance. Industry groups have predicted implementation costs could range as high as $16 billion.

In response to sharp criticism of its initial proposal, the SEC attempted to ease the burden on public companies in some areas.

Under the final rule, recycled or scrap minerals are not considered conflict minerals, and if a company is unable to determine the origin of its minerals, those minerals would be considered “conflict undeterminable.” The undeterminable category will last for two years for most companies and four years for smaller companies, and require an independent audit showing companies tried to identify the source of the minerals.

“The final rule is certainly more favorable to industry than the proposed rule,” Littenberg said. “On balance, it’s still a very onerous rule for many companies, but it is a better rule than first proposed.”

Still, business groups are likely readying legal challenges to block the rule, despite the SEC's attempts to answer their criticisms, attorneys said. The Chamber of Commerce and the Business Roundtable, both outspoken critics of the rule, are seen as likely plaintiffs.

"It would not surprise me, whether it's the Chamber of Commerce or the Business Roundtable that winds up challenging it," said Michael L. Hermsen, a partner with Mayer Brown LLP.

Business groups like the Chamber of Commerce would likely attack the conflict mineral rule by accusing the SEC of shirking its responsibility to conduct a proper analysis of its potential costs and benefits. The studies have become a favorite avenue for attack since the D.C. Circuit last year invalidated the SEC's proxy access rules after finding that it hadn't completed a proper cost-benefit analysis.

"The SEC has gotten their wrists slapped a couple times recently and they're very conscious of that," Hermsen said.

During Wednesday's meeting, SEC staffers heralded as exhaustive the cost-benefit study they conducted while putting together the conflict minerals rule, while admitting that its expected benefits — a reduction in the violence that has plagued the Democratic Republic of the Congo — were difficult to quantify, especially for an agency with no expertise in the areas of foreign or social policy.

The two dissenting SEC commissioners, Troy A. Paredes and Daniel M. Gallagher, did so in part because they believed the agency could not properly weigh the benefits of the rule and because they felt the SEC had no business setting social and foreign policy goals.

"How are we to determine whether the commission's many discretionary choices will promote as opposed to hinder the goal of peace and security in the DRC?" Paredes said.

Paredes and Gallagher's dissents could serve as templates for the legal challenge likely to come, attorneys said.

"I think there's quite a lot of room for litigation to challenge," said Sandra Flow, a partner with Cleary Gottlieb Steen & Hamilton LLP. "The basis for how you would make your argument is laid out in many of the comment letters, some of which was covered by the dissenting commissioners in the meeting."

--Editing by John Quinn and Lindsay Naylor.