SEC's "Conflict Minerals" Proposal Is Constitutionally Suspect

Apr 27 2011

Posted By: Beth Kushner

Practice Area: Securities Law

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Tucked into Dodd-Frank's 2,300-plus pages were a handful of provisions having nothing to do with either reforming Wall Street or protecting consumers. Instead, they are what one commentator has described as "the intrusion of foreign policy into federal securities legislation[.]'"[1] The provisions are contained in Section 1502 of Dodd-Frank, and amend the Securities Exchange Act of 1934 to require publicly-traded corporations that manufacture products using "conflict minerals"[2] to file an annual report with the Securities and Exchange Commission (SEC) and, annually, to disclose on company websites whether any of these minerals originated in the Democratic Republic of the Congo ("DRC"), or an adjoining country.[3] If "conflict minerals" originate in any of these countries, the company must submit to the SEC, and post on the company's website, a report that includes:

1. A description of the measures taken by the company to determine the source and chain of custody of such minerals, which measures shall include an independent private sector audit; and
2. Information about the products and audit.

Section 1502 has been called a "name and shame" law – shaming publicly-traded corporations obtaining conflict minerals from the identified countries.[4] Because publicly-traded corporations must report the potentially damaging "social responsibility" information to both the SEC and on the company's website, recipients of the compelled disclosures include both the company's existing stockholders and potential investors, and also actual and potential consumers of the publicly-traded corporation's products. If the compelled disclosures indicate a response that is less than what some might consider socially responsible corporate behavior, the economic consequences to the corporation could be severe.[5]

The Government regularly requires corporations to disclose information necessary to protect the integrity of the market for publiclytraded securities; indeed, this is the very purpose of the securities laws.[6] With Section 1502, Congress has moved the SEC beyond its role of protecting investors from the manipulation of stock prices to mandating corporate disclosure of information of social concern.

Section 1502 tests whether government-mandated public disclosure by publicly-traded corporations can indirectly effectuate foreign policy.[7] The statute attempts to do indirectly what the Government is politically reluctant to do directly. Congress has coercively enlisted publiclytraded corporations to assume the point position in an effort to determine whether public pressure from consumers and investors can effect a substantial change in the DRC's humanitarian crisis.[8]

While Congress' goal of alleviating the humanitarian crisis overseas cannot be questioned, a significant constitutional issue is posed by Section 1502 and the soon to be enacted SEC regulations – does the mandatory public disclosure of conflict minerals information violate the First Amendment rights of publicly-traded corporations? Because Section 1502 forces publicly-traded corporations to speak publicly on matters having nothing to do with the safety of their products or the economics of investing in their stock but, rather, compels those companies to speak to the general public on matters of public interest, the authors submit that Section 1502 likely violates the First Amendment. This is particularly so with respect to Section 1502's requirement that publicly-traded corporations disclose information to consumers on company websites, in addition to providing conflict minerals reports to the SEC.

Section 1502 and the First Amendment. "[A]s a general matter, the First Amendment means the Government has no power to restrict expression because of its message, its ideas, its subject matter, or its content." *Ashcroft v. American Civil Liberties Union*, 535 U.S. 564, 573 (2002). From a constitutional standpoint, there is no difference between compelled speech and compelled silence. *Riley v. National Federation of the Blind of North Carolina, Inc.,* 487 U.S. 781, 795-98 (1988); *Pacific Gas & Elec. Co. v. Public Utilities Comm'n of Cal.,* 475 U.S. 1, 11 (1986) (" Since all speech inherently involves choices of what to say and what to leave unsaid . . . there is necessarily . . . a concomitant freedom not to speak publicly . . . which serves the same ultimate end as freedom of speech in its affirmative aspect." (emphasis in original)). It also makes no difference whether the speaker is an individual or a corporation – "For corporations as for individuals, the choice to speak includes within it the choice of what not to say. . . . [S]peech does not lose its protection because of the corporate identity of the speaker. . . ." *Pacific Gas, supra*, 475 U.S. at 16.

The level of constitutional protection afforded particular speech, or the right to refrain from speaking on a particular subject, will turn on whether the speech is commercial, or is a noncommercial matter of general public concern. Laws that restrict (or require) noncommercial speech receive greater scrutiny than those governing purely commercial speech. *Bolger v. Youngs Drug Products Corp.,* 463 U.S. 60, 64-65 (1983).

Noncommercial speech concerning issues of public importance or concern occupies the highest rung in the hierarchy of the First Amendment values and is entitled to special protection. *Connick v. Myers*, 461 U.S. 138, 145 (1983); *Bolger, supra*, 463 U.S. at 65 ("With respect to noncommercial speech, this Court has sustained content-based restrictions only in the most extraordinary circumstances."). Restrictions on fully protected speech, or compelling such speech, are subject to "strict scrutiny" – they may be sustained only if the Government proves: (a) the interest the Government proffers in support of the restriction is "compelling;" (b) the ills the Government claims actually exist and the enactment will materially reduce them; and (c) less restrictive alternatives would not completely accomplish the Government's goals. *United States v. Playboy Entertainment Group Inc.,* 529 U.S. 803, 813 (2000); *Blount v. S.E.C.,* 61 F.3d 938, 944 (D.C. Cir. 1995).[9]

Commercial speech is afforded less constitutional protection. Speech may be characterized as "commercial" where (1) it is concededly an advertisement, (2) it refers to a specific product, or (3) it is motivated by an economic interest in selling the product. *Bolger, supra*, 463 U.S. at 66-69; *Cent. Hudson Gas & Elec. Corp. v. Public Service Comm'n*, 447 U.S. 557, 561 (1980). The test for determining whether a restriction on commercial speech is constitutionally permissible depends upon whether: (1) the asserted governmental interest in the regulation is substantial; (2) if so, the regulation directly advances the governmental interest asserted; and (3) if so, whether the regulation is not more extensive than necessary to serve that interest. *Thompson v. Western States Med. Ctr.,* 535 U.S. 357, 367 (2002); *Bolger, supra,* 463 U.S. at 68-69. These burdens are not satisfied by "mere speculation or conjecture . . . [A] governmental body seeking to sustain a restriction on commercial speech must demonstrate that the harms it identifies are real and that the restriction on speech will in fact alleviate them to a material degree." *Fla. Bar v. Went For It, Inc.,* 515 U.S. 618, 625-26 (1995). Moreover, if the Government can achieve its interest in a manner it does not regulate speech (or that regulates less speech), the Government must do so. *Thompson, supra*, 535 U.S. at 367, 371-72. [10]

In determining whether compelled disclosure of conflict minerals information to the public on company websites passes constitutional muster, the threshold issue is whether the information that must be disclosed is commercial, or whether the information is a subject of public importance and concern, and thus entitled to full First Amendment protection. Because the purpose of Section 1502 has nothing to do with preventing consumer deception, the required information proposes no commercial transaction with the public, the compelled disclosure does not relate solely to the interests of the speaker, and the disclosure on company websites is unrelated to stock ownership in the company or to marketing the company's securities, it would seem apparent that the compelled disclosures are not commercial speech. Rather, as evidenced by the declared purpose of Section 1502 – i.e., to reduce or eliminate the humanitarian crisis in the DRC by depriving armed groups of the economic benefits of commercial activity involving conflict minerals the information relates to matters of significant public concern. Speech concerning such a matter of public importance, or the right not to speak on this subject, likely enjoys full First Amendment protection. [11]

Although the Government may have a compelling interest in addressing the humanitarian crisis in the DRC, it is unlikely that the Government can establish that requiring only publicly-traded corporations to make the public disclosures mandated by Section 1502 of Dodd-Frank will materially reduce that crisis. This is particularly so in light of the provisions of Section 1502:

(a) The Secretary of State is to develop a "strategy" to "address the linkages" between the crisis, the mining of conflict minerals, and commercial products; and

(b) The Comptroller General is to assess and report on the "effectiveness" of the conflict minerals disclosures in addressing the crisis.

When Congress expressly states in Section 1502 that it needs the Comptroller General to determine whether compelled disclosures of public information on company websites would alleviate the crisis in the DRC, the Government will have great difficulty establishing, as it must under strict scrutiny, that the disclosures will materially reduce the crisis. Nothing in First Amendment jurisprudence permits Congress to compel speech entitled to full First Amendment protection to see if the compelled or regulated speech might accomplish a goal, even an undeniably worthy one.

Moreover, even if the Government could establish that Section 1502 will materially advance a compelling governmental interest, the Government would be hard pressed to establish that the goal cannot be achieved more directly in a manner that does not compel fully protected speech. *Thompson, supra*, 535 U.S. at 371-73. Here, the Government can achieve its purpose by prohibiting all corporations from trading with specified individuals or entities that financially benefit from the sale of conflict minerals – i.e., complete the work begun by Executive Order 13413, signed by former President Bush in 2006.[12] As the Court observed in *Thompson*, 535 U.S. at 371-72, 373: "The fact that [this alternative] could advance the Government's asserted interest in a manner less intrusive to First Amendment rights indicate[s] that the law was 'more extensive than necessary.' . . . [R]egulating speech must be a last – not first – resort." Finally, even if the mandatory Section 1502 public disclosures are considered to be commercial speech and, therefore, subject to a less stringent standard of review, the burden remains on the Government to defend them under the First Amendment. This means showing that the regulations directly advance a substantial governmental interest and are no more extensive than necessary to serve that interest. The Government must demonstrate that the harms it recites are real and that its restriction on speech will in fact alleviate them to a material degree. Further, if the Government can achieve its interests in a manner that does not regulate speech (or that regulates less speech), the Government must do so. *Thompson, supra*, 535 U.S. at 367-73. For the same reasons that Section 1502 likely would fail strict scrutiny analysis, at least with respect to the mandatory disclosure of conflict minerals information on company websites, the Government likely would be unable to meet its burden under the lesser intermediate standard of review.[13]

Conclusion. Although Congress' goal in enacting Section 1502 is laudable, the means it has chosen to achieve that goal appears to fail First Amendment scrutiny. Requiring publicly-traded corporations to assume the lead in achieving foreign policy objectives by compelling those companies to disclose information of public concern on company websites is unlikely to withstand a First Amendment challenge.[14]

---

[1] Shearman & Sterling LLP Client Publication, *The Dodd-Frank Act: New Disclosure Requirements for Reporting Issuers Engaged in Extractive Enterprises or Using Conflict Minerals,* July 29, 2010.

[2] "Conflict minerals" are mined in areas of armed conflict and human rights abuses, most notably in the Democratic Republic of Congo (DRC), and include tantalum, columbite-tantalite (coltan), tin, cassiterite, tungsten, wolframite, and gold. These minerals are used in producing a range of products.

[3] The adjoining countries are Angola, Burundi, Central African Republic, Congo Republic (a nation different from DRC), Rwanda, Sudan, Tarzania, Uganda, and Zambia.

[4] Peter Rosenblum, *When Financial Reform Meets Human Rights: Dodd-Frank Takes on Conflict Minerals*. Mr. Rosenblum is Director of the Human Rights Institute at Columba Law School.

[5] Notably, if a company is unable to determine the origin of minerals used in its products or processes, or if the company is unable to determine whether they are "conflict free," i.e., whether the product contains minerals directly or indirectly financing or benefitting armed groups in the DRC or adjoining countries, the company is required to disclose this to the public, the due diligence efforts it undertook, the specifics of any private sector audit, and the products manufactured where "conflict minerals" have been used.

[6] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976).

[7] Executive Order 13413, 71 Fed. Reg. 64105, signed in 2006 by President Bush, declared a national emergency in connection with the DRC crisis. In May 2009, the Department of the Treasury issued regulations to implement the Executive Order, and prohibited U.S. citizens from dealing with specifically identified individuals and entities. Because the sanctions are targeted, there is no broad-based sanction against either the people or the country of the DRC, and it is lawful to purchase conflict minerals other than from the identified sources.

[8] Indeed, Section 1502(d)(2) requires the Comptroller General to assess and, beginning two years after the effective date of Dodd-Frank, report to Congress on the "effectiveness" of the required public disclosures by publicly-traded corporations in addressing the humanitarian crisis in the DRC. *See infra* pp. 8-9.

[9] Under the strict scrutiny standard, a law restricting or compelling speech is presumptively invalid. *R.A.V. v. St. Paul*, 505 U.S. 377, 382 (1992).

[10] It is "well-established that the party seeking to uphold a restriction on commercial speech carries the burden of justifying it." *Edenfield v. Fane*, 507 U.S. 761, 770 (1993).

[11] Notably, the fact that fully protected speech may occur in the context of commercial speech does not eliminate the full First Amendment protection accorded that speech. *Riley, supra*, 487 U.S. at 796 ("We do not believe that the speech retains its commercial character when it is inextricably intertwined with [other] fully protected speech."); *Bolger, supra*, 463 U.S. at 66-68. Thus, the mere fact that publicly-traded corporations may advertise products on their websites – i.e., propose commercial transactions – does not mean that the Government's mandatory disclosure of matters of public concern causes that speech to lose its full First Amendment protection.

[12] *See* n. 8, *supra*.

[13] Even if the Government and the SEC could require conflict minerals information to be disclosed to existing and potential stockholders under either standard of review, the mandatory disclosure of conflict minerals information to the general public via company website is constitutionally flawed under both standards of review. See n. 9, *supra*.

[14] While beyond the scope of this article, Section 1502 disclosures may also present constitutional issues under the Fifth Amendment's Due Process Clause, as a violation of the right to equal protection. Statutory classifications may be unconstitutional when they are under-inclusive, and Section 1502 purports to address the humanitarian crisis in the DRC by requiring only publicly-traded corporations to investigate, audit and disclose. Privately held companies need do none of these things. Thus, Section 1502 creates a competitive disadvantage for publicly-traded corporations which may be invalid as a matter of equal protection. Moreover, proposed SEC rules also create a competitive disadvantage for U.S. publicly-traded corporations, vis-à-vis foreign companies, which is also of questionable constitutional validity.
