

CONFLICT MINERALS AND SEC DISCLOSURE REGULATION

Celia R. Taylor*

Mention the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank” or the “Act”),¹ and most people think of legislation aimed at “fundamental reform of the financial system”² focused on regulation of Wall Street practices and complex financial products. But tucked within the voluminous text of the Act (which consists of 2,300 pages and stipulates the passage of 387 rules by 20 different agencies³) is a provision having nothing to do with these issues or anything remotely related to them. Instead the “conflict minerals” provision of the Act requires companies that are subject to the reporting requirement of the federal securities laws to disclose whether they manufacture products using so-called “conflict minerals” sourced from the Democratic Republic of Congo (“DRC”) or contiguous countries.⁴

While I am an advocate of disclosure and of the use of disclosure requirements to increase corporate social responsibility, the conflict minerals provision of Dodd-Frank poses serious risks to the integrity of such efforts. The provision and the rules drafted to promulgate it go far beyond disclosure and may impede issuers’ ability to conduct business in the DRC region. The Securities Exchange Commission (“SEC”), which pursuant to Dodd-Frank is charged with promulgating rules to implement § 1502 (the conflict minerals provision), lacks knowledge of the issues surrounding conflict minerals,

* Professor Taylor teaches at the Sturm College of Law at the University of Denver. Her areas of interest include corporate governance, securities law, contract law, and legal drafting.

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

² Timothy Geithner, WSJ A19 Weds. July 20, 2011. Mr. Geithner, the U.S. Secretary of the Treasury states that the Act “was designed to lay a stronger foundation for innovation, economic growth and job creation with robust protections for consumers and investors and tough constraints on risk-taking.”

³ Jake Bernstein and Jesse Eisinger, *From Dodd-Frank to Dud: How Financial Reform May be Going Wrong*, PRO PUBLICA INC. (June 3, 2011), <http://mobile.propublica.org/article/from-dodd-frank-to-dud> (“Dodd-Frank requires 387 different rules from 20 different regulatory agencies . . . Congress set aggressive deadlines for regulators to make rules to enforce the law, and, unsurprisingly, they are failing to meet them. The agencies missed each of the 26 deadlines they were supposed to meet for April. So far, regulators have finalized 24 rules and missed deadlines on 28, according to the law firm Davis Polk.”)

⁴ Dodd-Frank Act § 1502(a); Exchange Act Release No. 34-63547 (proposed Nov. 18, 2010) (to be codified 17 C.F.R. pts. 229 & 249) (“The term “adjoining country” is defined in Section 1502(e)(1) of the Act as a country that shares an internationally recognized border with the DRC.”).

a fact its Chairman freely admits.⁵ The rules that the SEC has currently proposed are overly draconian, and strict enforcement of them will put the SEC into the position of dictating not only rules of corporate governance but of indirectly dictating daily corporate operation themselves, as the proposed provision will likely drive companies to stop dealing entirely in minerals from the DRC region.⁶ Although the conflict minerals provision is framed as a disclosure requirement and thus seemingly falls within the purview of the SEC, the provision in fact is a back-end run around which indirectly imposes a trade embargo on the DRC and an attempt to require action, through SEC regulation, that Congress has previously refused to authorize. As such, the conflict minerals provision as proposed exceeds the mandate of the SEC and the intent behind disclosure requirements of the securities laws.⁷ If the aim is to block the trade of conflict minerals, there are more appropriate mechanisms to do so. If the provision is revised sufficiently, it may be a useful disclosure tool and could serve as the model for future requirements aimed at improving corporate social responsibility.

This Article will first describe the history behind and the contents of § 1502 of Dodd-Frank and situate the provision within the philosophy of disclosure regulation underlying the federal securities acts, arguing that the provision goes far beyond the intent of disclosure regulation. It then considers other efforts to influence matters of general international import through SEC and other disclosure regimes, taking note of efforts in the areas of climate change, efforts to eliminate apartheid, and efforts to restrict trade in “blood diamonds.” It discusses the challenges that may face any conflict minerals provision and suggests that, despite problems with the provision, with some thoughtful revisions it could provide a valuable model for disclosure regulation of matters

⁵ At a SEC open meeting on December 15, 2010, Chairwoman Mary Schapiro and SEC staff freely spoke of the SEC’s lack of expertise regarding conflict minerals and other sustainability-related disclosures required by Dodd-Frank. *See SEC Open Meeting, Wednesday, December 15, 2010*, U.S. SECURITIES AND EXCHANGE COMMISSION (last modified December 23, 2010) <http://www.sec.gov/news/openmeetings/2010/121510openmeeting.shtml>.

⁶ Jonny Hogg, *Congo Miners Suffer as Traceability Rules Bite*, REUTERS, May 5, 2011, available at <http://www.reuters.com/article/2011/05/05/congo-democratic-minerals-idUSLDE7431UG20110505>; Amy Tsui, *Dodd-Frank Conflict Minerals Rule Said Tantamount to Embargo on D.R. Congo*, 43 *Sec. Reg. & L. Rep. (BNA)* 916 (May 2 2011) (quoting Rick Goss, vice president for environment and sustainability at the Information Technology Industry Council, who said Dodd-Frank’s Section 1502 is in effect an embargo and that Congress could not impose an actual embargo without running afoul of WTO rules).

⁷ *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963) (describing the purpose of the securities laws as “substituting a philosophy of full disclosure for the philosophy of caveat emptor . . .”); H.R. Rep. No. 73-1383, at 11 (1934), reprinted in 5 *Legislative History of the Securities Act of 1934* (J.S. Ellenberger & Ellen P. Mahar eds., 1973) (explaining the importance of providing investors with sufficient information to make intelligent investment decisions: “No investor . . . can safely buy and sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells. . . The hiding and secreting of important information obstructs the operation of the markets as indices of real value”); ANNE M. KHADEMIAN, *THE SEC AND CAPITAL MARKET REGULATION: THE POLITICS OF EXPERTISE* 83 (1992) (noting that “disclosure-enforcement” was the foundation of early securities regulation and remains the premise of the SEC’s regulatory activities today); Elaine A. Welle, *Freedom of Contract and the Securities Laws: Opting Out of Securities Regulation by Private Agreement*, 56 *WASH. & LEE L. REV.* 519, 534 (1999) (describing the start of federal involvement in securities regulation in the 1930s and noting that “from the beginning, the central focus of the federal regulatory structure has been disclosure”).

of social concern and could enable consumers to make informed choices about the sourcing of materials used in products. The approach described would support the goals of the securities laws, the philosophy informing the use of disclosure regulation generally, and the ultimate goal of decreasing funding to rebels in the DRC.

Section 1502: The Conflict Minerals Provision of Dodd-Frank

a. Overview

In adopting Section 1502 of the Dodd-Frank Act, Congress stated that “[i]t is the sense of the Congress 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 ... particularly sexual- and gender-based violence, and contributing to an emergency situation therein.”⁸ To address this concern, § 1502 amends the Securities Exchange Act of 1934 (the “Exchange Act”) by adding § 13(p) which requires the SEC to promulgate disclosure rules concerning the use of certain minerals that originate in the Democratic Republic of the Congo or its adjoining countries (the “DRC countries”).⁹ The new law and related proposed rules (primarily contained in the new Item 104 to Regulation S-K) have broad applicability.

Any reporting company that manufactures or contracts to manufacture products for which “conflict minerals” are “necessary to the functionality or production” of those products must comply with the regulation. Section 1502 defines “conflict minerals” as columbite-tantalite (coltan), cassiterite, gold, wolframite, or any of their derivatives.¹⁰ These minerals are widely used in industries ranging from electronic component manufacturers to jewelry makers to the aerospace industry, meaning § 1502 will have far reaching implications.¹¹

b. History and Policy of §1502

Section 1502 is not the first attempt by legislators to regulate conflict minerals, but earlier attempts proved fruitless. The partisan stalemate surrounding passage of Dodd-Frank presented a rich opportunity for politicians, who had previously tried without success, to introduce legislation to tack onto the Act, such as the conflict minerals and other provisions unrelated to the Act’s focus on financial reform.¹² In the case of the

⁸ Dodd-Frank Act § 1502(a).

⁹ Securities Exchange Act of 1934, 15 U.S.C. § 78 (1934).

¹⁰ *Id.*

¹¹ Columbite-tantalite is the metal ore from which tantalum is extracted. Tantalum is used in electronic components, including mobile telephones, computers, videogame consoles, and digital cameras, and as an alloy for making carbide tools and jet engine components. Gold is used for making jewelry and, due to its superior electric conductivity and corrosion resistance, is also used in electronic, communications, and aerospace equipment. Wolframite is the metal ore that is used to produce tungsten, which is used for metal wires, electrodes, and contacts in lighting, electronic, electrical, heating, and welding applications. Cassiterite is the metal ore that is most commonly used to produce tin, which is used in alloys, tin plating, and solders for joining pipes and electronic circuits. *See* Bryan Cave LLP, www.bryancave.com (last visited Dec. 28, 2011).

¹² *See, e.g.,* Disclosure of Payments by Resource Extraction Issuers, Dodd-Frank Act § 1504 (requiring all U.S. and foreign companies registered with the SEC to disclose payment to governments for oil, gas, and mineral extraction).

conflict minerals provision, Rep. Jim McDermott tried for years to pass a free-standing bill regulating conflict minerals¹³ and on November 19, 2009 introduced the Conflict Minerals Trade Act in the House.¹⁴ Similarly, on April 23, 2009, Senators Sam Brownback (R-KS), Dick Durbin (D-IL), and Russ Feingold (D-WI) introduced the Congo Conflict Minerals Act of 2009 to “require annual disclosure to the Securities and Exchange Commission of activities involving columbite-tantalite, cassiterite and wolframite for the Democratic Republic of Congo.”¹⁵ Neither of these legislative efforts ultimately prevailed as there was insufficient support from fellow politicians.

Refusing to give up, Senator Brownback saw his opportunity in the free-wheeling debate surrounding Dodd-Frank. After a short debate on the topic, §1502 was added, after which Rep. McDermott stated “[y]ou get bills passed any way you can.”¹⁶ In language largely reminiscent of the proposing language of Senator Brownback’s earlier failed bill, the adopting language for § 1502 states that Congress hoped the reporting requirements of the securities laws would help to curb the violence in the DRC by requiring transparency of all conflict minerals sourced from the DRC countries. Congress stated its concern in §1502(a) that “the exploitation and trade of conflict minerals originating in [that region] is helping to finance conflict that is characterized by extreme levels of violence ... particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation.”¹⁷

After Dodd-Frank was signed into law on July 21, 2010, the SEC had to promulgate new rules stipulating the precise disclosure required. Mary Schapiro, SEC Chairperson, acknowledged that the Commission lacked expertise in the area and accordingly, the proposed rules closely follow the statutory language, giving little guidance on key provisions and seeking comment on many of the requirements.¹⁸ An overview of the proposed rules implementing §1502 follows.

Overview of the Proposed Requirements of Section 1502

a. Application of the Section

The conflict mineral disclosure requirements apply to any reporting company for whom the designated minerals are “necessary to the functionality or production”¹⁹ of a

¹³ See Ben Protess, *Dodd-Frank Strays Far From Street*, N.Y. TIMES, July 14, 2011, <http://query.nytimes.com/gst/fullpage.html?res=980DE4DA153DF937A25754C0A9679D8B63>.

¹⁴ Conflict Minerals Trade Act, H.R. 4128, 111th Cong. (2009).

¹⁵ Congo Conflict Minerals Act of 2009, S. 891, 111th Cong. (2009).

¹⁶ Ben Protess, *Unearthing Exotic Provisions Buried in Dodd-Frank*, N.Y. TIMES, July 13, 2011, <http://dealbook.nytimes.com/2011/07/13/unearthing-exotic-provisions-buried-in-dodd-frank>.

¹⁷ Dodd-Frank Act § 1502(a).

¹⁸ After the rules were proposed by the SEC in December 2010, the agency held over ninety meetings and received over 250 comments from issuers, non-governmental organizations, and other stakeholders. On October 18, 2011, the SEC held a public roundtable to discuss the issue and extended the comment period until November 1, 2011. At the roundtable panelists addressed unresolved issues including: the definition of “conflict minerals” and “necessary to functionality or production”, the need for a *de minimis* exception, and the necessary due diligence required, among other matters.

¹⁹ Exchange Act Release No. 34-63547, 2010 WL 5121983 at 6 (proposed Nov. 18, 2010) (to be codified at 17 C.F.R. pts. 229 and 249) (citing to Exchange Act Section 13(p)(2)(B)).

product manufactured or contracted to be manufactured by that company. Neither the Act nor the proposed rules define what is meant by “necessary to the functionality or production” of a product, but the SEC states that it expects the section to apply to many industries and companies given the widespread use of the “conflict” minerals.²⁰

b. Determination of Whether Minerals are “Conflict Minerals”

If designated minerals are necessary to the functionality or production of an issuer’s product, the issuer is subject to § 1502. The issuer must then conduct a “reasonable country of origin inquiry” into the source of the designated minerals.²¹ If after conducting such an inquiry, the issuer determines that the designated minerals used in its product did not originate in the DRC countries, the issuer in its annual report must state this conclusion and explain the process engaged in when conducting the country of origin inquiry. The issuer must publish its conclusion on its website and maintain and make available for review business records demonstrating that the designated minerals did not originate in a DRC country.²²

c. Requirements if Conflict Minerals are Used

If an issuer determines that it does use conflict minerals in its product or is unable to determine with certainty where its minerals are sourced, it must state that conclusion in its annual report and on its website. In addition, any such issuer must include a conflict minerals report as an exhibit to its annual report and on its website. The conflict minerals report must describe the due diligence the issuer performed on the source and chain of custody of its conflict minerals and include a description of (i) the issuer’s products that are not “DRC conflict free,” (ii) the facilities used to process the conflict minerals, (iii) the conflict minerals’ country of origin, and (iv) the efforts used to determine the mine or location of origin with the greatest possible specificity.²³

d. Immediate Consequences of the Provision

The potential impact of these requirements is unknown but likely to be far-reaching and extreme. Few would argue with the desirability of improving transparency in the supply chains of conflict minerals, but the rules as currently proposed demand a level of government cooperation and power that may not be feasible. The unintended consequences of § 1502 may undermine any good intent of the provision if reaction to the proposed regulations are any indication. For example, in reaction to the proposed conflict minerals requirements, the Congolese government imposed an export ban on minerals from the eastern Congo between September 2010 and March 2011 with extreme consequences not on violence in the region but on the local populace. “Exporters were stuck with their stock and couldn’t get rid of it... the negociants [trade middle-men]

²⁰ *Id.*

²¹ *Id.* at 8.

²² *Id.*

²³ *Id.* at 20.

usually work on credits, but they weren't able to pay their arrears, so they had to mortgage their houses. In sum, the artisanal mining sector employed many, many people - these people lost their jobs over night. Also, many of them were demobilized soldiers, so this had the added effect of producing insecurity."²⁴ Additionally, planes used to transport minerals stopped flying to the region and therefore stopped supplying food and goods to the area.²⁵ Opponents of the ban are concerned it will lead to a rise in smuggling and fail to reduce widespread insecurity. The ban is already "damaging the economy in the east so badly [that one western donor is] considering humanitarian aid."²⁶

To prevent more unintended consequences, §1502 needs to be refined and implemented in a thoughtful way. If it is, it would fit comfortably within the disclosure regulation philosophy of United States securities laws and could serve as an important model for disclosure requirements spurring corporate social responsibility, a role both appropriate, and in my view desirable, for SEC rules and regulation.

The Philosophy of Disclosure Regulation in the Securities Act and the Exchange Act

To better understand how the conflict minerals provision fulfills the philosophy of disclosure regulation that underlies the United States securities laws, a (very) brief review of the history of that philosophy follows.

The philosophy of disclosure regulation that underlies United States securities laws is long-standing. After the stock market crash in 1929, deficiencies in US securities regulation became all too clear. Investors at the time got little if any accurate information about the securities they invested in and instead were subject to widespread manipulation and fraud.²⁷ To prevent a recurrence of this situation and to restore public confidence in the securities market, Congress passed the Securities Act of 1933 and the Securities Exchange Act of 1934.²⁸ The goal of the securities acts was to "prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor."²⁹ Disclosure was viewed as the most effective tool to achieve that goal³⁰ and a focus on

²⁴ See Interview with Eric Kajemba on Conflict Minerals, *available at* <http://congosiasa.blogspot.com/2011/08/interview-with-eric-kajemba-on-conflict.html> (2011).

²⁵ Katrina Manson, *Congo Miners Ban Puts Stress on Firms and Workers*, REUTERS, Sept. 30, 2010, *available at* <http://www.reuters.com/article/2010/09/30/us-congo-democratic-tin-idUSTRE68T2R920100930>.

²⁶ *Id.*

²⁷ See Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 BAYLOR L.REV. 139, 150 (2006) (hereinafter "Ripken"); Alan B. Levenson, *The Role of the SEC as a Consumer Protection Agency*, 27 BUS. LAW, 61, 61 (1971) (citing H.R. Rep No. 73-85, at 2 (1933)).

²⁸ Securities Act of 1933, 15 U.S.C. 77a-77aa (2000 & Supp. II 2002); Securities Exchange Act of 1934, 15 U.S.C. 78a-78nn (2000 & Supp. II 2002).

²⁹ Regulation of Securities, S. REP. NO. 73-47, at 1 (1933), reprinted in 2 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934 (J.S. Ellenberger & Ellen P. Mahar eds., 1973).

³⁰ Stephen J. Choi & A.C. Pritchard, *Behavioral Economic and the SEC*, 56 STAN. L. REV. 1, 71 (2003) ("Disclosure is the primary tool of the present U.S. securities regulatory regime."). See also James A. Fanto, *We're All Capitalists Now: The Importance, Nature, Provision and Regulation of Investor Education*, 49 CASE W. RES. L. REV. 105, 156 (1998) (describing the SEC's traditional mission as disclosure related to securities transactions).

disclosure as a regulatory tool is reflected in both the Securities Act and the Securities Exchange Act.

a. The Securities Act

An important focus of the Securities Act was the prevention of fraud in the offering of securities through disclosure of relevant information about the issuers of offered securities. Felix Frankfurter, a strong influence on the drafting of the Securities Act, continually stressed the need for transparency and openness in corporate affairs.³¹ Disclosure regulations were to ensure that investors had sufficient information to make informed choices and were to be designed to recognize that “[f]air play is the most essential ... The information that must be furnished in the registration statement is intended to reveal facts essential to a fair judgment upon the security offered.”³² The emphasis on disclosure regulation was explicitly acknowledged by the drafters of the Securities Act who stressed that one of the principles underlying the legislation was the full disclosure of every essentially important element attending the issuance of new securities.³³

b. The Securities Exchange Act

While the Securities Act focuses its disclosure requirements on issuers undertaking the issuance of new securities, the disclosure provisions of the Securities Exchange Act are aimed at issuers whose shares already trade. A central disclosure provision of the Securities Exchange Act, § 14(a), regulates proxy disclosure.³⁴ That section grants the SEC broad authority to promulgate rules and regulations that it deems “necessary or appropriate in the public interest or for the protection of investors.”³⁵ Congress’ purpose in enacting § 14 was to give the SEC authority to “require disclosure of facts concerning how companies were being managed ... including ‘not only...the financial condition of the corporation,’ but also the ‘major questions of policy’ ... including ‘adequate explanation of the management policies [insiders] intend to pursue.’”³⁶

The disclosure philosophy reflected in United States securities laws has deep roots and strong support. Early proponents championed the need for disclosure to promote transparency and fairness in the market. Later scholars stress many benefits of disclosure, among them the belief that disclosure is beneficial because investors make

³¹ See, e.g., Felix Frankfurter, *The Federal Securities Act: II*, FORTUNE, Aug. 1933, at 55.

³² *Id.*

³³ The team of drafters included James Landis, Benjamin Cohen, and Thomas Corcoran who identified three main principles to be served by the Securities Act. In addition to the above stated disclosure principle these principles were a recognition that the government, in regulating securities, is not engaged in guaranteeing or approving the worth of the securities, and a demand that the persons, whether they be directors, experts, or underwriters, who sponsor the investment of other people’s money should be held up to the high standards of trusteeship.. See Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1228 (1999) (citing H.R.REP. NO. 73-85, at 2 (1933)).

³⁴ Exchange Act 14(a), 15 U.S.C. 78n (1994).

³⁵ *Id.*

³⁶ Williams, *supra* note 36, at 1245 (citing H.R. REP. NO. 73-1383, at 13-14 (1934)).

better decisions and managers act in ways more suited to investor interest when they have full information; that full disclosure leads to market accuracy because stock prices better reflect underlying firm value; and that fraud is lessened because “sunlight is said to be the best of disinfectants, electric light the best policeman.”³⁷ While there is great debate in academic literature over the utility of mandatory disclosure³⁸ and whether disclosure should remain the focus of the securities law, most agree that disclosure is a net positive and efforts now tend to focus on expanding its reach.

Disclosure to Advance Social Goals

Due to the strong disclosure philosophy underlying United States securities laws, the US securities markets are renowned for their financial transparency.³⁹ That transparency is not as pervasive when it comes to disclosure of corporate activities that have a social impact, although there has long been support for the idea that corporations should expand their non-financial disclosure⁴⁰ from advocates of greater corporate social responsibility (“CSR”).⁴¹ Proponents argue that “[i]f private corporations have contributed to society’s problems, [they should] be accountable for those contributions; ... they should be accountable simply to disclose to their shareholders the extent of the negative consequences of their pursuits ... Expanded corporate social disclosure seeks to provide greater information ... concerning these [negative] actions so that shareholders can determine the extent to which they approve of the trade-offs management has made between economic returns and social and environmental effects.”⁴²

The idea that the SEC can (and should) promote greater social disclosure has strong support in the statutory language of the securities acts, as eloquently argued by Professor Cynthia Williams and others.⁴³ Many companies already recognize the value of enhanced social disclosure and voluntarily engage in CSR reporting.⁴⁴

³⁷ LOUIS D. BRANDEIS, *OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT* 92 (1914).

³⁸ Geoffrey A. Manne, *The Hydraulic Theory of Disclosure Regulation and Other Costs of Disclosure*, 58 ALA. L. REV. 473 (2007).

³⁹ See ARNOLD S. JACOBS, *Disclosure as a Policy*, in 5B DISCLOSURE AND REMEDIES UNDER THE SECURITIES LAWS § 6:8 (2011), available at Westlaw SECDRL. See also *Allen v. Lloyd’s of London*, 1996 WL 490177, at *23 (E.D. Va. 1996) *rev’d on other grounds*, 94 F.3d 923 (4th Cir. 1996) (“[T]he ‘Commission’s basic philosophy . . . has been one of disclosure.’”) (citing LOSS & SELIGMAN, *FUNDAMENTALS OF SECURITIES REGULATION* 437 (3d ed. 1995)).

⁴⁰ See, e.g., David F. Linowes, *The Corporate Social Audit*, SOCIAL RESPONSIBILITY AND ACCOUNTABILITY 95 (Jules Backman ed. 1975) (recognizing the need for and providing a model of social audits for corporations).

⁴¹ There are many definitions of corporate social responsibility. As used herein, CSR generally refers to the right or responsibility of corporate managers to take into account the interests of a broad range of stakeholders in addition to their corporation’s shareholders when engaging in corporate activity. CSR advocates suggest that directors should cause their corporations to take purposeful action to minimize the harmful impacts and increase the positive impacts their firm has on the environment, the communities they interact with, and their employees, among others.

⁴² Williams, *supra* note 36, at 1295.

⁴³ See generally *id.* See also Eric Engle, *What You Don’t Know Can Hurt You: Human Rights, Shareholder Activism and SEC Reporting Requirements*, 57 SYRACUSE L. REV. 63 (2006).

⁴⁴ See KPMG International, *KPMG International Survey of Corporate Social Responsibility Reporting* 2008, available at

The SEC is capable of promoting non-strictly financial disclosure. Recently, the SEC addressed specifically disclosure obligations with regard to climate change.⁴⁵ Acknowledging that there “have been significant developments in federal and state legislation and regulation regarding climate change,”⁴⁶ the Commission issued guidance to help issuers interpret existing disclosure rules as they relate to climate change.

On the surface, the conflict minerals provision is a similar form of disclosure regulation. The violence in the DRC is a social concern, and disclosure of issuers’ activities in the region are aimed at addressing it. But there are significant differences between the climate change disclosures called for by the SEC and disclosure requirements stipulated by the conflict minerals provision—differences that push the conflict minerals provision too far.

Climate Change and Conflict Minerals Disclosure: A Comparison

A significant feature of the climate change disclosure guidance issued by the SEC is its focus on disclosure of the cost of compliance with applicable (or potentially applicable) rules and regulations other than those imposed by the SEC. For example, issuers are told to disclose, under Item 101 of Regulation S-K, “any material estimated capital expenditures for environmental control facilities for the remainder of a company’s current fiscal year and its succeeding fiscal year and for such further periods as the company may deem material.”⁴⁷ Similarly, under Item 103 of Regulation S-K, issuers are to disclose any material pending legal proceeding.⁴⁸ These disclosures allow investors to determine the extent of an issuer’s environmental compliance and the costs that may be associated with any non-compliance and to assess the likely impact of future regulation on the issuer.

In contrast, the conflict minerals provision does not call for disclosure of the cost of compliance with laws nor for the costs of potential litigation concerning exports from the DRC, nor could it as trade in conflict minerals is not illegal. Rather, it calls for a comprehensive analysis of an issuer’s supply chain in the region and requires issuers to make assessments about the sourcing of its products that may not be possible. This disclosure is not aimed at revealing important information about an issuer’s financial well-being but rather at stopping issuers from dealing in the minerals covered by the section. Section 1502 is in reality not a disclosure provision but an attempt to implement a political agenda through SEC regulation. The conflict minerals provision is not the first attempt by the United States to affect the politics of other countries through legislative

http://www.kpmg.com/EU/en/Documents/KPMG_International_survey_Corporate_responsibility_Survey_Reportin_g_2008.pdf (reporting that as of 2008, seventy-nine percent of the world’s largest corporations issued a stand-alone CSR report and an additional four percent included CSR disclosure in their annual reports). The majority of issuers engaging in CSR reporting use disclosure standards developed by the Global Reporting Initiative, a non-profit organization based in Amsterdam. More information about GRI is available at <http://www.globalreporting.org>.

⁴⁵ Commission Guidance Regarding Climate Change, SEC Release Nos. 33-9106, 34-61469, FR-82 2010 WL 2199526 (Feb. 8, 2010).

⁴⁶ *Id.* at 22.

⁴⁷ 17 CFR § 229.101(c)(1)(xii) (2011).

⁴⁸ 17 CFR § 229.103 (2011).

action. Prior efforts, however, were explicit in their political objective and their use of the political process to achieve that objective. To give just two examples, consider how the US challenged apartheid in South Africa and then the trade in “blood diamonds.”

a. Anti-Apartheid Efforts

Apartheid, South Africa's state system of institutionalizing racial segregation, was long condemned by the international community.⁴⁹ The United States supported international efforts to end apartheid, and, during the Reagan administration, initiated a policy known as “constructive engagement,” which imposed limited economic sanctions against the apartheid regime while encouraging change in South Africa through a muted dialogue with the country's white minority leaders. Shortly thereafter, in 1986, Congress passed the Comprehensive Anti-Apartheid Act of 1986.⁵⁰

The purpose of the Act was “to set forth a comprehensive and complete framework ...to help [] bring an end to apartheid in South Africa.”⁵¹ The Act included economic sanctions, a prohibition on new investment, and a prohibition of imports and exports of raw materials and agricultural products.⁵² It also required certain US businesses to comply with the Sullivan Principles,⁵³ a code of fair employment practices. In June 1987, Congress passed a measure imposing a trade embargo and requiring complete divestment from South Africa.⁵⁴

The sanctions imposed on South Africa by the United States and the international community were not the only factor in bringing the end of apartheid, but “the international sanctions movement against the South African government was the final push that brought the National Party to near bankruptcy and brought them to the negotiating table with the ANC.”⁵⁵

The US political response to apartheid demonstrates that when the US wants to stop certain behaviors in other nations, it can work through appropriate national and international political channels to achieve that goal. The violence plaguing the DRC is, like apartheid, a social problem that has global impact. It should be addressed on that level, not through a disclosure provision in SEC regulation.

b. Trade in “Blood Diamonds”

⁴⁹ See generally Jennifer Frankel, *The Legal and Regulatory Climate for Investment in Post-Apartheid South Africa: An Historical Overview*, 6 CARDOZO J. INT'L & COMP. L. 183 (1998).

⁵⁰ Comprehensive Anti-Apartheid Act of 1986, Pub. L. No. 99-440, 100 Stat. 1086 (1986) (hereinafter Anti-Apartheid Act).

⁵¹ *Id.* at § 3.

⁵² *Id.* at §§ 301-323.

⁵³ In 1975, at the request of South African black leaders, Rev. Leon Sullivan of Philadelphia started to formulate a code of conduct for American companies doing business in South Africa. See *A Conversation with the Rev. Sullivan; Going All-Out Against Apartheid*, N.Y. TIMES, July 27, 1986, available at 1986 WLNR 831549. See also Robert R. Kuehn, *Access to Justice: The Social Responsibility of Lawyers – Denying Access to Legal Representation: The Attack on the Tulane Environmental Law Clinic*, 4 WASH. U. J.L. & POL'Y 33, 119 n.410 (2000).

⁵⁴ See Economic Sanctions Against South Africa, 21 WKLY. COMP. PRES. DOC. 1048-55 (Sept. 16, 1985).

⁵⁵ Alexander Laverty, *Impact of Economic and Political Sanctions on Apartheid*, THE AFRICAN FILE (June 7, 2007) <http://theafricanfile.com/academics/ucsd-2/impact-of-economic-and-political-sanctions-on-apartheid>.

Coordinated international efforts also were used in response to the blood diamond trade. Blood diamonds (or conflict diamonds) are “diamonds that originate from areas controlled by forces or factions opposed to legitimate and internationally recognized governments, and are used to fund military action in opposition to those governments.”⁵⁶ Blood diamonds, like conflict minerals, contribute directly to the history of violence in the DRC and other nations as each provide revenue to rebel factions and deny revenue to legitimate governments.⁵⁷

The negative public perception of the blood diamond trade and pressure from non-governmental organizations (“NGOs”) led to both political action and a private certification scheme aimed at stopping the trade. On the political front, starting in the late 1990s and thereafter, the United Nations passed resolutions imposing sanctions on the import of blood diamonds.⁵⁸ Nations around the world followed suit and banned the import of blood diamonds. In 2003, the United States Congress passed the Clean Diamond Trade Act (the “CDTA”).⁵⁹ The CDTA bans the importation of uncertified diamonds into the United States in an effort to guarantee that conflict diamonds stay out of the country.⁶⁰

In order to allow trade in “legitimate” (non-conflict) diamonds to continue, a certification program was created. Known as the Kimberly Process Certification Scheme (the “KPCS”)⁶¹, the program is now followed by seventy-four nations.⁶²

The KPCS establishes a mandatory certification system to break the link between the blood diamond trade and the conflict in African nations including the DRC. The KPCS requires each participating nation to implement legislation that stipulates “a requirement that all shipments of rough diamonds imported to or exported from [the nation is] certified under the scheme.”⁶³ All diamonds shipped under the KPCS must be accompanied by a certificate stating that the diamonds are not blood diamonds and must include identification markers, including, among others, a unique tracking number, the issuing authority, and the identity of the exporter or importer.⁶⁴

There is debate about the efficacy of the KPCS. Proponents argue that “[a]s a result of the Kimberley Process Certification Scheme, diamonds are among the most

⁵⁶ See United Nations Department of Public Information, *Conflict Diamonds: Sanctions and War* (Mar. 21, 2001), available at <http://www.un.org/peace/africa/Diamond.html> (hereinafter “Conflict Diamonds”).

⁵⁷ *Id.* See also Final Report of the Panel of Experts on the Illegal Exploitation of Natural Resources and Other Forms of Wealth in the Democratic Republic of Congo, U.N. SCOR, 57th Sess., U.N. Doc S/2002/1146 (2002).

⁵⁸ See generally Conflict Diamonds, *supra* note 59.

⁵⁹ Clean Diamond Trade Act, Pub. L. No. 108-19, 117 Stat. 631 (2003) (“An Act To implement effective measures to stop trade in conflict diamonds, and for other purposes”).

⁶⁰ *Id.*

⁶¹ See THE WORLD DIAMOND COUNCIL, THE ESSENTIAL GUIDE TO IMPLEMENTING THE KIMBERLEY PROCESS (2003), available at <http://www.jvclegal.org/KimberleyProcess.pdf>.

⁶² See DIAMOND FACTS.ORG, COUNTRIES PARTICIPATING IN THE KIMBERLEY PROCESS, available at http://www.diamondfacts.org/pdfs/conflict/Kimberley_Process_Participants.pdf.

⁶³ NATURAL RESOURCES CANADA, KIMBERLY PROCESS FOR ROUGH DIAMONDS – BACKGROUND, <http://www.nrcan.gc.ca/minerals-metals/business-market/4146> (last visited Dec. 28, 2011).

⁶⁴ See THE WORLD DIAMOND COUNCIL, *supra* note 64.

monitored and audited of any natural resource in the world. This system has proven to be an essential and effective tool in combating the scourge of conflict diamonds."⁶⁵ Detractors counter that illegal smuggling of diamonds continues and that the KPCS has an "inability or unwillingness to come to grips with some very serious problems."⁶⁶ Without attempting to settle this debate, it can be stated that there is general agreement that the KPCS has contributed to the slowing of the blood diamond trade. Like the international reaction to the apartheid regime, the worldwide response to blood diamond trade shows the benefit of coordinated international action and coordinated sanctions and certifications. These approaches are far better suited to dealing with serious issues such as those presented by the situation in the DRC. Rather than hiding the political objective of stopping trade in conflict minerals in a SEC disclosure regulation, the goal should be approached directly and openly.

Likely Challenge to the Conflict Minerals Provision

Section 1502 is likely to face challenges in addition to those created by the deficiencies discussed above. Whenever the SEC proposes new rules or regulations it must comply with certain statutory requirements⁶⁷ and must conduct a cost benefit analysis to determine if an action is necessary or appropriate in the public interest and promotes efficiency, competition, and capital formation.⁶⁸ While these provisions may seem pro forma, they could pose challenges for the conflict minerals provision. As recently stated by the D.C. Circuit Court of Appeals, any failure of the SEC to "apprise itself—and hence the public and Congress—of the economic consequences of proposed regulation' makes promulgation of the rule arbitrary and capricious and not in accordance with law."⁶⁹ Courts have used these standards several times recently to strike down SEC action on new rules.⁷⁰ In a scathing rejection of proposed proxy access rules, the D.C. Circuit Court noted the SEC "inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted

⁶⁵ U.S. DEP'T OF STATE, CONFLICT DIAMONDS, <http://www.state.gov/e/eb/diamonds> (last visited Dec. 28, 2011) (quoting Eli Izhakoff, Chairman World Diamond Council).

⁶⁶ James Melik, *Diamonds: Does the Kimberley Process Work?*, BBC WORLD SERVICE - BUSINESS DAILY, (June 28, 2010) available at www.bbc.co.uk/news/10307046 (quoting a former Kimberley Process officer).

⁶⁷ These include, among others, the Paperwork Reduction Act, 44 U.S.C. § 3501 (2011), the Small Business Regulatory Enforcement Fairness Act, Pub. L. 104-121, Title II, 110 Stat. 857 to 874 (1996), and the Initial Regulatory Flexibility Act, 5 U.S.C. § 603 (2011).

⁶⁸ Securities Exchange Act of 1934, 15 U.S.C. § 78(c)(f) (2011).

⁶⁹ *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (citations omitted) (striking down proxy access rules that would have given shareholders who owned at least 3% of a company's stock for at least three years the ability to include a slate of directors in their company's proxy materials).

⁷⁰ *See, e.g., id.*; *Am. Equity Invest. Life Ins. Co. v. SEC*, 613 F.3d 166, 167-68 (D.C. Cir. 2010) (striking down rule stating that fixed indexed annuities (FIAs) are not annuity contracts within the meaning of the Act thereby making FIAs subject to the full panoply of requirements set forth by the Act, instead of being subject solely to state insurance laws); *Chamber of Commerce v. SEC*, 412 F.3d 143, 146 (D.C. Cir. 2005) (finding that the Commission failed adequately to consider a proposed alternative before imposing an independent chairman requirement on investment companies).

itself; and failed to respond to substantial problems raised by commentators.”⁷¹

I am by no means suggesting that the conflict minerals provision would suffer a similar fate. However, given the broad range of industries and companies likely to be affected by the rule and the uncertainty of its application and impact, it would not be surprising if the rule is challenged in court. A recent letter from the Office of Advocacy, an independent office within the Small Business Administration, to the SEC is evidence of this likelihood. The Office of Advocacy expresses its concern that the proposed rule fails to comply with the Regulatory Flexibility Act as it “appears to underestimate both the costs that the proposed rule will impose and the number of small businesses that will be impacted by the proposal.”⁷² While the SEC is not obligated to amend rules it proposes in reaction to comments from the Office of Advocacy (or any other commentator), the Small Business Jobs Act of 2010 does require agencies to give every appropriate consideration to comments provided by them.⁷³ The position of the Office of Advocacy lends ammunition to a party challenging the rules and increases the likelihood that courts will strike them down.

Section 1502 could serve a useful purpose if it is tailored to require disclosure of information to investors that could realistically be provided from issuers that would enable investors to make informed investment choices that could impact corporate behavior and advance the reforms sought by the conflict minerals provision.

Section 1502 as a Model for Social Disclosure

As currently proposed, the conflict minerals provision of Dodd-Frank overreaches its bounds. With careful revision however, the provision could serve as a useful model for social disclosure regulation by requiring that issuers provide investors with information relevant to their investment decision without intruding into the daily operations of companies. How would this work? First, the regulation must be drafted to account for the realities confronted by issuers who use the designated minerals in their products and who commented on the proposal. While much of the comments and conversation focuses on the electronics sector, “the issue is much broader with industries from automotive, medical devices, consumer products, defense, capital goods, retail, to aerospace all affected.”⁷⁴ The SEC should not bow to industry desires, but it should take reasonable account of comments and concerns as industry members are better situated to assess the realities of a conflict minerals provision.

Recognition of industry concerns would suggest that in the short run § 1502 should require that issuers who deal in the designated minerals disclose in their annual report that the issuer cannot guarantee that it does not use minerals sourced from conflict

⁷¹ Business Roundtable, *supra* note 72, at 1148-49.

⁷² Letter from Office of Advocacy to the SEC (Oct. 25, 2011), *available at* <http://www.sec.gov/comments/s7-40-10/s74010-349.pdf>.

⁷³ Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2504, § 1601 (2010).

⁷⁴ Letter from Advanced Medical Technology Association et.al., to Mary L. Schapiro, Chairperson of the SEC, *available at* <http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specializeddisclosures-57.pdf>.

areas. Precisely what areas are deemed to be conflict areas should be carefully defined.⁷⁵ Recognizing that conditions in the region change rapidly, issuers should be entitled to rely on government-issued maps to determine at the date of extraction of the minerals whether they were sourced from mines in a conflict region.

The rules should allow companies to determine what constitutes reasonable due diligence. The statute requires issuers to report on the due diligence that they exercise over the source and chain of custody of minerals mined in the conflict region but does not define what due diligence will be sufficient. Given the diversity of industries affected by the conflict minerals provision, there should be flexibility to tailor due diligence to suit specific supply chains. The SEC could provide checks to ensure that the due diligence performed was sufficient to discover and report on all material matters covered by § 1502 but should leave the precise parameters to each issuer.

Similarly, the definition of whether a particular conflict mineral is “necessary to functionality or production” must be carefully delineated. To prevent overly restrictive use of the provision, the phrase should be defined to cover only conflict minerals that are intentionally added by the issuer to the final product and that are essential to the product’s use or purpose. Further, products containing conflict minerals and conflict minerals already in should be exempt.

The rules should also provide an exemption for recycled materials because there is no way downstream users can trace the origin of recycled materials. Exempting recycled minerals is consistent with the purpose of the conflict minerals provision. Section 1502, designed to stop funding the atrocities in the DRC, is based on the assumption that DRC rebel groups are funded by operating mines to extract and sell ore and by extracting tariffs from those transporting ore. By the time minerals are recycled, rebel groups have already extracted their revenue. The use of recycled minerals would further the intent of stopping the initial mining of conflict minerals by reducing the demand for ore.

In the long term, conflict mineral disclosure should be tied to broader international efforts to address the link between trade in such minerals and the violence in the DRC. Social issues of general international importance should be confronted by the international community in a consistent and coherent manner.

To that end, disclosure under § 1502 should require issuers to state whether they comply with an internationally designed and independently monitored supply chain verification program, similar to the certification scheme created with regard to blood diamonds. Efforts to establish such a third party supply chain verification scheme are in process at the Organization for Economic Cooperation and Development (“OECD”).

⁷⁵ At least one country identified as a conflict region in the draft provision challenges that classification. *See Gold Exports Under Threat*, THE GUARDIAN, Feb. 28, 2011, <http://www.ippmedia.com/frontend/index.php?l=26503> (citing Peter Kafumu, Tanzanian Commissioner of Minerals) (“Drafters of the Act mentioned Tanzania as part of DRC. They made a mistake to mention Tanzania as part of DRC, and as one of conflict-prone countries...we are a conflict-free country,” said Kafumu, adding: “We will not be affected by the new US mineral Act, because we are not a conflict country...that is we don’t see the need to submit a petition to challenge this law”).

OECD Action with Regard to Conflict Minerals

On May 25, 2011, the OECD⁷⁶ Ministerial Council adopted a Recommendation on OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (“OECD Guidance”).⁷⁷ The OECD Guidance is a government-backed multi-stakeholder initiative aimed at creating transparent mineral supply chains in conflict areas to enable companies to avoid contributing to conflict through their mineral sourcing practices, while at the same time enabling countries to benefit from their natural resources.⁷⁸ Although not legally binding, the action by the Ministry Council reflects “the common position and political commitment of OECD members and non-members adhering to the OECD Declaration on International Investment and Multinational Enterprises.”⁷⁹

The Guidance provides a due diligence framework for responsible supply chains⁸⁰ of minerals from conflict and high risk areas. The framework consists of five steps, including, among others, requirements to identify and assess risk in the supply chain, design and implement a strategy to respond to identified risks, and carry out an independent third-party audit of supply chain due diligence at identified points.⁸¹ It also provides a model supply chain policy that stipulates certain actions adopters have agreed to engage in, including, among others, immediately suspending engagement with upstream suppliers when there is a reasonable risk that such suppliers are committing serious abuses and taking the same action when upstream suppliers are sourcing their supplies from any party providing direct or indirect support to certain non-state armed groups.⁸² In sum, the Guidance provides step-by-step recommendations for implementation of responsible supply chains of minerals from conflict-affected and high-risk areas. It is intended to cultivate transparent, conflict-free supply chains and sustainable corporate behavior in the minerals sector.

The OECD initiative should be considered by the SEC in drafting final rules to implement the conflict minerals provisions. Coordinating US disclosure with international efforts would allow concentrated efforts on a large scale that have a greater likelihood of making a real impact in the DRC. It would allow social disclosure

⁷⁶ The OECD is the Organization for Economic Co-operation and Development. It is a forum where governments work together to address the economic, social, and environmental challenges of globalization. As of 2011, OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

⁷⁷ ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, OECD DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS (2011), available at <http://www.oecd.org/dataoecd/62/30/46740847.pdf>.

⁷⁸ *Id.* at Foreword.

⁷⁹ *Id.*

⁸⁰ A supply chain involves multiple actors engaged in the extraction, transport, handling, trading, processing, smelting, refining and alloying, manufacturing, and sale of the final product. *Id.* at 13.

⁸¹ *Id.* at Annex I: Five-Step Framework for Risk-Based Due Diligence in the Mineral Supply Chain.

⁸² *Id.* at Annex II: Model Supply Chain Policy for a Responsible Global Supply Chain of Minerals from Conflict-Affected and High-Risk Areas.

regulation to serve its purpose and enable the SEC to craft regulations that further the purpose of stated goals without imposing unrealistic and unworkable burdens on issuers.

Conclusion

The goal of reducing funding opportunities for rebel groups in the DRC and surrounding conflict regions is admirable. However, use of a conflicts minerals provision imposing excessively burdensome and unworkable disclosure requirements on issuers pursuant to SEC regulation is not the best way to achieve that goal. SEC disclosure regulation can be an effective mechanism to enforce social norms and policies, but should work in conjunction with broader national and international efforts when the subject matter of the regulation is one of great international political and economic importance. Disclosure regulation should be used to further the policies underlying the securities laws—that of providing full information to investors of all matters material to their investment decision. As proposed, the conflict minerals provision goes far beyond this mandate. Disclosure regulation is a powerful tool and should be used appropriately. The conflict minerals provision could serve as a valuable model for social policy disclosure regulation but will do so only if it is thoughtfully drafted and implemented.