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# THE MATERIALITY OF MORALITY: CONFLICT MINERALS

Alexandrea L. Nelson\*

## I. INTRODUCTION

*Shareholder activism is not a privilege—it is a right and a responsibility. When we invest in a company, we own part of that company and we are partly responsible for how that company progresses. If we believe there is something going wrong with the company, then we, as shareholders, must become active and vocal.*<sup>1</sup>

What is material to the investor? The traditional answer would be any financially relevant information that would change how an investor would make a purchasing decision. In 2010, Congress pushed securities regulation into a new realm of materiality: morality. Buried in the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) is a mandate that requires the Securities and Exchange Commission (SEC) to promulgate rules governing the disclosure of “conflict minerals.”<sup>2</sup> Coined the “Brownback Amendment,”<sup>3</sup> section 1502 of Dodd-Frank requires the SEC to adopt new rules that would require certain public companies to report the use of conflict minerals originating in and around the Democratic Republic of Congo (DRC).<sup>4</sup>

Conflict minerals include minerals and metals found in everyday items, from mobile telephones and gaming consoles to jet engine components.<sup>5</sup> Congress found that U.S. companies’ “exploitation” and use of conflict minerals originating in the DRC is aiding and financing a “conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation . . . .”<sup>6</sup> The motivation behind section 1502 was to use the threat of investor accountability to force U.S. companies to examine their supply chains and

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<sup>1</sup> Mark Mobius, *Knowing Your Shareholder Rights*, FRANKLIN TEMPLETON INVS. (Apr. 2, 2010), <http://mobius.blog.franklintempleton.com/2010/04/02/knowning-your-shareholder-rights/>.

<sup>2</sup> 15 U.S.C. § 78m(p)(1)(A) (2012).

<sup>3</sup> 156 CONG. REC. S3976 (daily ed. May 19, 2010) (statement of Sen. Feingold) (stating that the “Brownback amendment is a significant, practical step toward” addressing the DRC crisis).

<sup>4</sup> 15 U.S.C. § 78m(p)(1)(A).

<sup>5</sup> 17 C.F.R. § 240.13p-1 (2013).

<sup>6</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1502(a), 24 Stat. 1376, 2213 (2010).

determine whether their products are funding atrocious human rights violations. This marks a major shift in the SEC's traditional role as a market regulator of financially material information or financial reporting that bears directly on a company's stock performance.<sup>7</sup> As such, section 1502, and the subsequent Conflict Minerals Rule adopted by the SEC, has been met with severe criticism.<sup>8</sup> Scholars argue that not only will this disclosure rule be ineffective, but also that it is an inappropriate use of securities regulation because the information bears no relation to stock performance.<sup>9</sup>

This Note has two purposes. The first purpose is to provide a thorough understanding of the Conflict Minerals Rule—to give a background of the rule, to understand Congress's motivations, and to show how the rule will be influential in shaping investor behavior. To do this, Part II examines the history behind section 1502, including the humanitarian crisis in the DRC, and Part III outlines the SEC's implementation of section 1502 and its current legal challenges. The second purpose of this Note is to make an argument that despite its critics, section 1502 represents inherently material information—that is, morality and humanitarian factors are material to investors. Part IV explores two arguments purporting that the Conflict Minerals Rule is a disclosure requirement that represents material information. First, aside from its humanitarian goals, section 1502 also represents real financial consequences including tort liability, insurance costs, and potential penalties related to international labor and humanitarian law violations. These costs are just as material to an investor as a quarterly earnings report. Second, the rise of the socially responsible investor has shifted the paradigm away from accounting and financial information, demanding more transparency on issues of human rights and social responsibility—issues of morality are material. Finally, Part V concludes.

## II. DODD-FRANK AND THE DRC

The global relief effort in the DRC is ongoing. Every year, the United States contributes millions of dollars to promote peace in the DRC region.<sup>10</sup> More

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<sup>7</sup> See *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SEC. & EXCHANGE COMM'N (June 10, 2013), <http://www.sec.gov/about/whatwedo.shtml> [hereinafter *Investor's Advocate*] (“[T]he SEC requires public companies to disclose meaningful financial and other information to the public.”).

<sup>8</sup> See *infra* Part IV.

<sup>9</sup> See, e.g., Karen E. Woody, *Conflict Minerals Legislation: The SEC's New Role as Diplomatic and Humanitarian Watchdog*, 81 *FORDHAM L. REV.* 1315, 1339 (2012) (“[T]he obligation to disclose a fact that, absent the legislative requirement, likely would not affect a reasonable investor's decision to invest in a company, is problematic from both a securities law standpoint and a public international law standpoint . . .”).

<sup>10</sup> U.S. GOV'T ACCOUNTABILITY OFFICE, *THE DEMOCRATIC REPUBLIC OF THE CONGO: SYSTEMATIC ASSESSMENT IS NEEDED TO DETERMINE AGENCIES' PROGRESS TOWARD U.S. POLICY OBJECTIVES 12* (2007) [hereinafter *DRC REPORT*].

recently, Congress has tried several different legislative attempts to combat violence in the DRC.<sup>11</sup> However, Dodd-Frank's section 1502 comprises the first time Congress has successfully passed legislation that would create a system of supply-chain accountability, which theoretically will address violence in the DRC.<sup>12</sup> This Part first outlines the complex DRC conflict. Next, this Part provides a brief outline of the past failed attempts in DRC legislation and the current Dodd-Frank mandate.

A. *An Estimated Forty-Five Thousand People Die Every Month in the DRC as a Result of Violence, Poverty, and Disease*<sup>13</sup>

The DRC is one of the most violent countries in the world. From 1998 to 2007, an estimated 5.4 million Congolese people died as a result of “violence, disease, and starvation.”<sup>14</sup> Located in the center of Africa, the country is roughly the size of the United States east of the Mississippi River.<sup>15</sup> The current violence is a result of the DRC's complicated history and two complex civil wars that raged between 1996 and 2003.<sup>16</sup> Today, the DRC's vast and lucrative natural resources are at the core of the continued violence.<sup>17</sup> “[T]he mismanagement and illicit trade of extractive resources from the [DRC] supports conflict between militias and armed domestic factions in neighboring countries.”<sup>18</sup> Armed groups use murder, starvation, and sexual crimes to maintain power over mining zones.<sup>19</sup> The violence and instability created by armed groups has contributed to the DRC being one of the “poorest and least developed” countries in the world.<sup>20</sup> In 2013, the Human Development Report ranked the DRC 186 on the Human Development Index,

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<sup>11</sup> See *infra* section II.B.

<sup>12</sup> See *id.*

<sup>13</sup> See Congo Conflict Minerals Act of 2009, S. 891, 111th Cong. § 2(3) (2009).

<sup>14</sup> David C.W. Wagner, Note, *Breaking the Nexus Between Armed Conflict and Consumer Products: Where's the App for That?*, 26 TEMP. INT'L & COMP. L.J. 103, 108 (2012); see also S. 891, § 2(3).

<sup>15</sup> DRC REPORT, *supra* note 10, at 5.

<sup>16</sup> *A Short History of the Conflict in the Democratic Republic of Congo and the Involvement of NGOs in the Peace Process*, WORLD MOVEMENT FOR DEMOCRACY, <http://www.wmd.org/resources/whats-being-done/ngo-participation-peace-negotiations/history-conflict-democratic-republic> (last visited Mar. 3, 2014).

<sup>17</sup> See DRC REPORT, *supra* note 10, at 5, 25 (noting that natural resources constitute the DRC's primary exports and include “34 percent of world cobalt reserves; 10 percent of world copper reserves; 64 percent of world coltan reserves; and significant amounts of wood, oil, coffee, diamonds, gold, cassiterite, and other minerals” and that “[t]he DRC's abundant natural resources are serving as an incentive for conflict between neighboring countries' militias and armed domestic factions”).

<sup>18</sup> S. 891, § 2(5); see also DRC REPORT, *supra* note 10, at 24–25.

<sup>19</sup> See S. 891, § 2.

<sup>20</sup> DRC REPORT, *supra* note 10, at 7.

joining Niger in the lowest possible ranking out of the countries where data is available.<sup>21</sup>

The DRC's main exports include columbite-tantalite, cassiterite, wolframite, and gold.<sup>22</sup> These resources are grossly undervalued, and armed groups profit from these resources by "coercively exercising control over mining sites from where they are extracted and locations along which they are transported for export."<sup>23</sup> Armed groups use cheap mining practices to further obtain profit. Mining in the DRC is largely conducted through "artisanal miners, who use hand-held tools to extract minerals from underground sources and rivers."<sup>24</sup> These miners often work in deplorable conditions; they lack protective clothing and safety equipment, and they are often "exposed to a range of health risks, such as falling rocks and dust inhalation."<sup>25</sup> Additionally, child labor is a common source of mining production.<sup>26</sup>

Sexual violence and rape are common tools used by armed groups to maintain power over helpless mining communities. In 2010, a study revealed that DRC women are victimized at a rate of nearly one rape every minute.<sup>27</sup> This study also estimated that around 1.8 million Congolese women have been victims of rape.<sup>28</sup> Widespread government corruption is also contributing to the crisis in the DRC. The DRC's "weak and abusive security forces" are unable to eradicate the armed groups and are "poorly disciplined, ill equipped, and the worst abusers of human rights in the DRC."<sup>29</sup>

To combat the violence and the destruction, the U.N. has passed numerous resolutions,<sup>30</sup> and the United States has provided millions of dollars in aid to the

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<sup>21</sup> U.N. DEV. PROGRAM, HUMAN DEVELOPMENT REPORT 2013, THE RISE OF THE SOUTH: HUMAN PROGRESS IN A DIVERSE WORLD 147 (2013), available at [http://hdr.undp.org/sites/default/files/reports/14/hdr2013\\_en\\_complete.pdf](http://hdr.undp.org/sites/default/files/reports/14/hdr2013_en_complete.pdf).

<sup>22</sup> DRC REPORT, *supra* note 10, at 5; see also S. 891, § 2(8).

<sup>23</sup> S. 891, § 2(8).

<sup>24</sup> AMNESTY INT'L, PROFITS AND LOSS: MINING AND HUMAN RIGHTS IN KATANGA, DEMOCRATIC REPUBLIC OF THE CONGO 6 (2013), available at [http://www.amnesty.org/en/library/asset/AFR62/001/2013/en/7052e03b-89db-43b3-b607-7f0c8e11f18d/afr620012013\\_en.pdf](http://www.amnesty.org/en/library/asset/AFR62/001/2013/en/7052e03b-89db-43b3-b607-7f0c8e11f18d/afr620012013_en.pdf).

<sup>25</sup> *Id.*

<sup>26</sup> *Id.* at 14 ("The presence of child workers in the mines in Katanga is a serious problem. Some 40,000 children under the age of 16 years are believed to be working on mine sites in Kolwezi, Kipushi and Likasi.").

<sup>27</sup> See Amber Peterman et al., *Estimates and Determinants of Sexual Violence Against Women in the Democratic Republic of Congo*, 101 AM. J. PUB. HEALTH 1060, 1064–65 (2011) (estimating that every five minutes, four women in the DRC are raped).

<sup>28</sup> See *id.* at 1063.

<sup>29</sup> DRC REPORT, *supra* note 10, at 19–20 ("[T]he DRC army is responsible for 40 percent of recently reported human rights violations—including rapes, mass killings of civilians, and summary executions—and DRC police and other security forces have killed and tortured civilians with total impunity.").

<sup>30</sup> See *infra* Part II.B.

DRC to improve security in an effort to curtail the violence.<sup>31</sup> In 2007, the United States provided \$181.5 million to the DRC in the form of humanitarian, economic, social-development, governance, and security aid.<sup>32</sup> However valiant these efforts, the crisis in the DRC continues and the U.N. has urged its member states to “ensure that importers, processing industries and consumers of Congolese mineral products under their jurisdiction exercise due diligence on their suppliers and on the origin of the minerals they purchase.”<sup>33</sup> The idea behind the U.N. resolutions was to force user accountability to defund armed groups causing instability in the region.<sup>34</sup> As I will discuss below, the United States has answered this call by passing section 1502 of Dodd-Frank, which creates supply chain accountability.

*B. Past Legislative Efforts to Combat Violence in the DRC and Dodd-Frank Section 1502*

In 2001, the U.N. Security Council adopted a resolution that proclaimed its “grave concern at the repeated human rights violations” throughout the DRC and called on the “international community to increase, without delay, its support for humanitarian activities.”<sup>35</sup> In 2010, the U.N. Security Council recommended that its member states “enhance information sharing [of conflict minerals practices] and joint action at the regional level to investigate and combat regional criminal networks and armed groups involved in the illegal exploitation of natural resources.”<sup>36</sup> Even before this admonition, and many others from the U.N.,<sup>37</sup> Congress first attempted to pass the Conflict Coltan and Cassiterite Act of 2008 (CCCA).<sup>38</sup> The CCCA aimed to prohibit importation of products that contained or were derived from columbite-tantalite or cassiterite mined or extracted from the DRC.<sup>39</sup> Introduced in 2008, the CCCA never received a floor vote and thus failed.<sup>40</sup> Congress’s second attempt was the Congo Conflict Minerals Act of 2009 (CCMA).<sup>41</sup> The CCMA resembled section 1502 of Dodd-Frank, and it called on the SEC to require annual disclosure of activities involving use of “columbite-tantalite, cassiterite, and wolframite” from the DRC.<sup>42</sup> However, the CCMA was

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<sup>31</sup> DRC REPORT, *supra* note 10, at 12.

<sup>32</sup> *Id.*

<sup>33</sup> S.C. Res. 1857, ¶ 15, U.N. Doc. S/RES/1857 (Dec. 22, 2008).

<sup>34</sup> *See id.*

<sup>35</sup> S.C. Res. 1376, ¶¶ 5–6, U.N. Doc. S/RES/1376 (Nov. 9, 2001).

<sup>36</sup> S.C. Res. 1952, ¶ 19, U.N. Doc. S/RES/1952 (Nov. 29, 2010).

<sup>37</sup> *See, e.g.*, S.C. Res. 1857, *supra* note 33, ¶ 15.

<sup>38</sup> Conflict Coltan and Cassiterite Act of 2008, S. 3058, 110th Cong. § 1 (2008).

<sup>39</sup> *Id.* pmb. (stating the purpose of the bill was to “prohibit the importation of certain products that contain or are derived from columbite-tantalite or cassiterite mined or extracted in the Democratic Republic of Congo, and for other purposes”).

<sup>40</sup> S. 3058 (110th): Conflict Coltan and Cassiterite Act of 2008, GOVTRACK.US, <https://www.govtrack.us/congress/bills/110/s3058> (last visited Mar. 3, 2014).

<sup>41</sup> Congo Conflict Minerals Act of 2009, S. 891, 111th Cong. § 1 (2009).

<sup>42</sup> *Id.* pmb.

also unsuccessful.<sup>43</sup> The third and successful attempt was the addition of section 1502 to Dodd-Frank.

In passing section 1502, Congress felt that the need for conflict mineral disclosure was “literally [a] life-and-death issue.”<sup>44</sup> Section 1502 amended the Securities and Exchange Act of 1934 (“Exchange Act”), adding a new disclosure requirement under subsection 13(p) that directs the SEC to create a rule to compel companies using conflict minerals to disclose that information on their websites.<sup>45</sup> Congress summed up its intent in introducing section 1502:

It is the sense of 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 in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation therein, warranting the provisions of section 13(p) of the Securities Exchange Act of 1934, as added by subsection (b).<sup>46</sup>

Conflict minerals are defined under Dodd-Frank as “columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives; or any other minerals or its derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country.”<sup>47</sup> Section 1502 will require companies using conflict minerals to undertake a diligent effort to determine whether those minerals originated in the DRC and adjoining countries.<sup>48</sup> If a company concludes after a diligent effort that their minerals are not directly or indirectly financing or benefiting armed groups in the DRC or adjoining countries, the company may list their products as “DRC conflict free.”<sup>49</sup> To define and properly implement this law, Congress required the SEC to create rules that would fulfill this disclosure mandate no later than 270 days after the passage of Dodd-Frank.<sup>50</sup>

### III. THE SEC’S RULE AND SUBSEQUENT LEGAL CHALLENGE

This Part will outline the SEC’s disclosure requirements under section 1502, the financial-reporting impact on U.S. companies, and the disclosure’s potential effect on future market behavior. This Part also discusses the first major legal

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<sup>43</sup> *S. 891 (111th): Congo Conflict Minerals Act of 2009*, GOVTRACK.US, <https://www.govtrack.us/congress/bills/111/s891> (last visited Mar. 3, 2014).

<sup>44</sup> 156 CONG. REC. S3817 (May 17, 2010) (statement of Sen. Durbin).

<sup>45</sup> 15 U.S.C. § 78m(p)(1)(E) (2012).

<sup>46</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 1502(a), 124 Stat. 1376, 2213 (2010).

<sup>47</sup> *Id.* § 1502(e)(4).

<sup>48</sup> *See* 15 U.S.C. § 78m(p)(1)(A).

<sup>49</sup> *Id.* § 78m(p)(1)(A)(ii).

<sup>50</sup> *Id.* § 78m(q)(2)(A).

challenge to the Conflict Minerals Rule, its failure in the district court, and its pending appeal.

A. *The SEC's Conflict Minerals Rule*

Dodd-Frank left many questions unanswered, with the SEC facing an uphill battle to determine some of the subtleties of the Dodd-Frank language. The Conflict Minerals Rule encompasses many public companies in the United States and, as such, has garnered national attention.<sup>51</sup> The rule is far reaching in determining which minerals qualify as “conflict” and which issuers under the Exchange Act are required to comply. The minerals the rule encompasses will be discussed here; the issuer requirements are better understood in the context of the rule’s application.

The SEC adopted the same definition of a conflict mineral as Dodd-Frank, including “cassiterite, columbite-tantalite, gold, wolframite, or their derivatives, or any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the Covered Countries.”<sup>52</sup> The following table lists the common industry uses of conflict minerals.<sup>53</sup>

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<sup>51</sup> See Conflict Minerals, 77 Fed. Reg. 56,274, 56,278 (Sept. 12, 2012) (discussing how the SEC received over thirteen thousand comment letters during the rulemaking process).

<sup>52</sup> *Id.* at 56,283. Many commentators admonished the SEC to define the term “derivatives” to ensure unambiguous application. *Id.* at 56,285. The SEC agreed with the “ambiguity” of the word and adopted the rule that derivatives are limited to the “3Ts”—tantalum, tin, and tungsten—“unless the Secretary of State determines that additional derivatives are financing conflict in the Covered Countries, in which case they are also considered ‘conflict minerals.’” *Id.*

<sup>53</sup> *Id.* at 56,283–84.



<b>Conflict Mineral</b>	<b>Common Use</b>
Cassiterite	Tin production which is used in alloys, tin plating, and solders for joining pipes and electric circuits
Columbite-tantalite	An ore from which niobium and tantalum is extracted
Tantalum	Mobile telephones, computers, videogame consoles, digital cameras, and used as an alloy for making carbide tools and jet engine components
Gold	Jewelry, electronics communications, and aerospace equipment
Wolframite	Mineral used to produce tungsten, which is used for metal wires; electrodes; and contacts in lighting, electronics, electrical, heating, and welding applications

The SEC noted in its final report that “[b]ased on the many uses of these minerals, we expect the Conflict Minerals Statutory Provision to apply to many companies and industries and, thereby, the final rule to apply to many issuers.”<sup>54</sup> The industry has estimated that this rule will affect at least six thousand issuers, which is about half of all publicly traded companies in the United States.<sup>55</sup> The rule became effective November 13, 2012, with a compliance date of May 31, 2014.<sup>56</sup>

The Conflict Mineral Rule is fairly complex; however, it can be broken down into three general steps. Step one is a question of threshold, where issuers will have to examine whether their business practices fall within the purview of the rule.<sup>57</sup> Step two asks issuers who do fall within the rule to complete a “reasonable country of origin inquiry” to determine the source of their supply chain.<sup>58</sup> Step three requires companies that have found or suspect their materials originate in the DRC and surrounding countries (hereinafter referred to as “Covered Countries”) to conduct a chain of custody analysis to determine where in the Covered Countries the materials originate, whether in warlord-controlled mines or legitimate business operations.<sup>59</sup>

<sup>54</sup> *Id.* at 56,284.

<sup>55</sup> KPMG INT’L, CONFLICT MINERALS PROVISION OF DODD-FRANK: IMMEDIATE IMPLICATIONS AND LONG-TERM OPPORTUNITIES FOR COMPANIES 2 (2011), *available at* <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/dodd-frank-conflict-minerals.pdf>.

<sup>56</sup> Conflict Minerals, 77 Fed. Reg. at 56,309.

<sup>57</sup> *Id.* at 56,279.

<sup>58</sup> *Id.* at 56,280.

<sup>59</sup> *Id.* at 56,280–91.

*1. Issuers Required to Report Under the Conflict Minerals Rule*

There are two aspects of applying the first step of the Conflict Minerals Rule. First, the issuer must determine, based on its reporting status, whether the issuer categorically falls within the Conflict Mineral Rule.<sup>60</sup> Second, if the issuer falls categorically within the rule, it must determine whether conflict minerals are necessary to the functionality or production of its product.<sup>61</sup>

The Conflict Mineral Rule categorically applies to any issuer who “files reports with the Commission under Section 13(a) or Section 15(d) of the Exchange Act, including domestic companies, foreign private issuers, and smaller reporting companies.”<sup>62</sup> The SEC determined this to be the appropriate application of section 1502 because the only limiting factor found in the Dodd-Frank issuer language was that the minerals must be “necessary to the functionality or production of products manufactured or contracted by the issuer to be manufactured.”<sup>63</sup> This definition of applicability sweeps up over half of the public companies in the United States.<sup>64</sup> Additionally, the rule was not confined to direct manufacturers using conflict minerals. The SEC determined that the congressional intent was to capture all issuers where “conflict minerals are necessary to the functionality or production” of their products.<sup>65</sup> Therefore, the rule applies to both directly manufacturing<sup>66</sup> issuers and issuers who contract to manufacture.<sup>67</sup> Issuers who contract to manufacture are those issuers who have “actual influence over the manufacturing of their products.”<sup>68</sup> The SEC provided the example of a cell phone service provider who specifies to the manufacturer that the device must be able to work on

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<sup>60</sup> *Id.* at 56,279.

<sup>61</sup> *Id.*

<sup>62</sup> *Id.* at 56,287.

<sup>63</sup> *Id.* (citations omitted) (internal quotation marks omitted).

<sup>64</sup> KPMG INT’L, *supra* note 55, at 2.

<sup>65</sup> Conflict Minerals, 77 Fed. Reg. at 56,290.

<sup>66</sup> *Id.* at 56,290–91.

<sup>67</sup> *Id.*

<sup>68</sup> *Id.* at 56,291. An issuer should not be viewed as contracting to manufacture a product if its actions involve no more than

(a) Specifying or negotiating contractual terms with a manufacturer that do not directly relate to the manufacturing of the product . . . unless the issuer specifies or negotiates taking actions so as to exercise a degree of influence over the manufacturing of the product that is practically equivalent to contracting on terms that directly relate to the manufacturing of the product; or

(b) Affixing its brand, marks, logo, or label to a generic product manufactured by a third party; or

(c) Servicing, maintaining, or repairing a product manufactured by third party.

*Id.*

a certain network.<sup>69</sup> This type of market behavior does “not in-and-of-itself exert sufficient influence” to be considered “contract to manufacture.”<sup>70</sup>

The Conflict Mineral Rule does not apply to “an issuer that mines or contracts to mine . . . unless the issuer also engages in manufacturing, whether directly or indirectly through contract . . . .”<sup>71</sup> If the issuer finds that it does not manufacture or contract to manufacture conflict minerals, the issuer’s next step is to determine whether the use of conflict minerals are “necessary to the functionality or production” of their product.<sup>72</sup> If so, Dodd-Frank mandates that issuers disclose such.<sup>73</sup>

Whether a mineral is necessary to the functionality or production of a product was arguably the most contested portion of the Conflict Minerals Rule. The SEC chose not to define what is necessary to the production or functionality of a product, instead opting to provide issuers guidance. To determine what is necessary to the functionality of a product, the SEC suggested that an issuer should evaluate

- (1) Whether a conflict mineral is intentionally added to the product or any component of the product and is not a naturally-occurring by-product; (2) whether a conflict mineral is necessary to the product’s generally expected function, use, or purpose; or (3) if a conflict mineral is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration.<sup>74</sup>

A similar standard applies to determine what is necessary to produce a product.<sup>75</sup> Some issuers urged the SEC to adopt a de minimis exception to protect an issuer’s products that contain “trace, nominal, or insignificant amounts” of the conflict mineral.<sup>76</sup> The SEC cited the lack of a de minimis exception in the statutory language of section 1502 and relied heavily on the State Department’s

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<sup>69</sup> *Id.* at 56,291.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.* at 56,292.

<sup>72</sup> *Id.* at 56,285.

<sup>73</sup> 15 U.S.C. § 78m(p)(2)(B) (2012).

<sup>74</sup> Conflict Minerals, 77 Fed. Reg. at 56,279.

<sup>75</sup> *Id.* To evaluate what is necessary to the production of a product, the SEC suggested that issuers ask

- (1) Whether the conflict mineral is intentionally included in the product’s production process, other than if it is included in a tool, machine, or equipment used to produce the product (such as computers or power lines); (2) whether the conflict mineral is included in the product; and (3) whether the conflict mineral is necessary to produce the product.

*Id.*

<sup>76</sup> *See Id.* at 56,295.

finding that many products contain conflict minerals in “very limited quantities” and, therefore, a de minimis exception “could have a significant impact on the final rule.”<sup>77</sup> If the issuer determines that conflict minerals are not necessary to the functionality or production of its products, the issuer’s reporting obligations end. All other covered issuers will proceed to step two.<sup>78</sup>

## 2. *Determining Whether Conflict Minerals Originated in Covered Countries and the Resulting Disclosure*

Step two requires issuers to perform a “reasonable country of origin inquiry” to determine if their conflict minerals originated in the Covered Countries.<sup>79</sup> This is the most discretionary step, allowing the issuer to determine the appropriate inquiry into the origination of its conflict minerals.<sup>80</sup> The SEC has provided some guidance, requiring issuers to use due diligence “reasonably designed to determine whether the issuer’s conflict minerals did originate in the Covered Countries, or did come from recycled or scrap sources”; additionally, this inquiry must be completed in “good faith.”<sup>81</sup> This may require issuers to obtain representations from facilities and immediate suppliers demonstrating that the conflict minerals did not originate in the Covered Countries.<sup>82</sup>

Depending on the results of this inquiry, the issuer may need to proceed to step three. If the issuer finds that its conflict minerals did not originate in or “has no reason to believe” that its minerals “may” have originated in the Covered Countries (including recycled or scrap minerals), the issuer’s disclosure obligations are minimal.<sup>83</sup> These issuers must disclose the results (e.g., scrap, recycled, or non-Covered Country origin) and the steps taken in the reasonable country of origin inquiry to the SEC.<sup>84</sup> This disclosure is required on the Form SD or Special Disclosure that was created by the SEC to accommodate new disclosures under Dodd-Frank.<sup>85</sup> Additionally, an issuer will have to disclose that its conflict minerals did not originate in the DRC by posting the Form SD to the issuer’s website.<sup>86</sup> After these disclosures, the issuer’s reporting obligations end.

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<sup>77</sup> *Id.* at 56,298 (citations omitted).

<sup>78</sup> *See id.* at 56,283.

<sup>79</sup> *Id.* at 56,310.

<sup>80</sup> *Id.* at 56,311–12. The SEC determined that because a reasonable country of origin inquiry can “differ among issuers based on the issuer’s size, products, relationships with suppliers, or another factor,” issuers should be free to tailor their reasonable country of origin inquiry. *Id.* at 56,311.

<sup>81</sup> *Id.* at 56,312.

<sup>82</sup> *Id.*

<sup>83</sup> *Id.* at 56,313.

<sup>84</sup> *Id.*

<sup>85</sup> *Id.* at 56,280.

<sup>86</sup> *Fact Sheet: Disclosing the Use of Conflict Minerals*, SEC. & EXCHANGE COMM’N, <http://www.sec.gov/News/Article/Detail/Article/1365171562058#.UuKEWmTn-iZ> (last visited Mar. 11, 2014) [hereinafter *Fact Sheet*].

Conversely, if the issuer “knows” or has “reason to believe” that its minerals originated in the Covered Countries, the issuer must proceed to step three.<sup>87</sup>

### 3. *The Conflict Minerals Rule and Supply Chain Due Diligence*

Step three of the Conflict Minerals Rule applies to issuers who know or have reason to know that their conflict minerals originated in the Covered Countries. These issuers are required to use a “nationally or internationally recognized due diligence framework,” if available for the specific mineral, to determine the source and chain of custody of their conflict minerals.<sup>88</sup> For each issuer, depending on the results of its due diligence and chain of custody analysis, the reporting obligations under the Conflict Minerals Rule will differ.<sup>89</sup>

First, if an issuer finds its minerals are either from scrap or recycled sources or do not originate in the Covered Countries, the reporting obligations are minimal.<sup>90</sup> These issuers are only required to file a Form SD disclosing the issuer’s findings (e.g., scrap, recycled, or non-Covered Countries origin), a description of the reasonable country of origin inquiry, and the issuer’s due diligence measures undertaken.<sup>91</sup> The rule also requires the issuer’s determination to be posted on the issuer’s website and for the issuer to provide a link to this web address on the Form SD.<sup>92</sup>

Second, if the issuer determines that its conflict minerals originate or may originate in the Covered Countries and are not from recycled or scrap resources, the issuer is required to complete a Conflict Minerals Report (CMR) in addition to the Form SD disclosures.<sup>93</sup> The CMR is a reflection of the issuer’s conflict status (i.e., whether the minerals have or have not been found to be DRC conflict free).<sup>94</sup> For a product to be labeled “DRC conflict free,” an issuer must determine that its product “do[es] not contain conflict minerals that directly or indirectly finance or benefit armed groups” in the Covered Countries.<sup>95</sup> Conversely, products that are not found to be DRC conflict free are products containing minerals that can be traced directly or indirectly to financing or benefiting armed groups.<sup>96</sup> Every CMR must include “a description of the measures the issuer has taken to exercise due

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<sup>87</sup> *Id.*

<sup>88</sup> Conflict Minerals, 77 Fed. Reg. at 56,326.

<sup>89</sup> *Fact Sheet*, *supra* note 86.

<sup>90</sup> Conflict Minerals, 77 Fed. Reg. at 56,313.

<sup>91</sup> *Id.*

<sup>92</sup> *See Fact Sheet*, *supra* note 86.

<sup>93</sup> Conflict Minerals, 77 Fed. Reg. at 56,316. A CMR is an exhibit that is included in the Form SD report. *Id.* at 56,360. The issuer must also disclose a link to the issuer’s website where the CMR is publically available. *Id.*

<sup>94</sup> *See id.* at 56,320.

<sup>95</sup> *Id.* at 56,322. DRC conflict free issuers are not required to label their products as conflict free in the CMR; rather, issuers are permitted to disclose the lack of conflict on the Form SD. *Id.* at 56,323.

<sup>96</sup> *See id.* at 56,322.

diligence on the source and chain of custody of [the issuer's] conflict minerals," along with "a certified independent private sector audit."<sup>97</sup> The purpose of the private sector audit is to validate the CMR by ensuring that it conforms to a nationally recognized due-diligence framework.<sup>98</sup> Additional disclosures may be required on the CMR depending on the issuer's conflict status.

Including the general CMR disclosures, issuers who are not DRC conflict free must also report the following on their CMRs: (1) which products manufactured are not DRC conflict free; (2) the facilities used in processing the conflict minerals; (3) the country of origin; and (4) the efforts to determine the location of the mine with the "greatest possible specificity."<sup>99</sup> Significantly, the SEC does not require that issuers label or disclose the conflict mineral status on their products;<sup>100</sup> rather, the CMR must be publically displayed only on the issuer's website.<sup>101</sup> DRC conflict free issuers have no further reporting obligations on the CMR.<sup>102</sup>

Issuers that are unable to say with certainty where their minerals originated or whether their trade practices are benefiting or financing armed groups are given a two-year window in which they can label their products as "DRC conflict undeterminable."<sup>103</sup> This allows issuers more time to investigate the chain of custody of their conflict materials. DRC conflict undeterminable issuers will include the following on their CMRs: (1) the products manufactured or contracted to be manufactured that are DRC conflict undeterminable; (2) country of origin, if known; (3) facilities used to process the conflict minerals; (4) the efforts undertaken to determine the mine location within the "greatest possible specificity"; and (5) the steps the issuer has or will take to mitigate the risk that its minerals will finance or benefit armed groups.<sup>104</sup> No independent audit is required for this type of CMR.<sup>105</sup>

### B. National Ass'n of Manufacturers v. SEC<sup>106</sup>

In true regulatory fashion, the Conflict Minerals Rule has received backlash from both the industry and scholars.<sup>107</sup> The rule's complexity and high cost of compliance have driven the industry to the courts. In July 2013, the District Court

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<sup>97</sup> *Id.* at 56,320. The independent private-sector audit must be conducted in accordance with the standards established by the Comptroller General of the United States. *Id.*

<sup>98</sup> *Id.* at 56,329.

<sup>99</sup> *See Fact Sheet, supra* note 86.

<sup>100</sup> Conflict Minerals, 77 Fed. Reg. at 56,323.

<sup>101</sup> *See Fact Sheet, supra* note 86.

<sup>102</sup> *Id.*

<sup>103</sup> Conflict Minerals, 77 Fed. Reg. at 56,281. Smaller companies have four years. *Id.* at 56,321.

<sup>104</sup> *See Fact Sheet, supra* note 86.

<sup>105</sup> Conflict Minerals, 77 Fed. Reg. at 56,283.

<sup>106</sup> 956 F. Supp. 2d 43 (D.D.C. 2013).

<sup>107</sup> *See, e.g., id.* at 51–53 (summarizing commentator's concerns with the passage of the Conflict Minerals Rule); Woody, *supra* note 9, at 1320.

for the District of Columbia ruled on the first major challenge to the SEC's Conflict Minerals Rule.<sup>108</sup> This litigation brought to light many of the industry's issues with the SEC's interpretation of Dodd-Frank. The plaintiffs, the National Association of Manufacturers, the U.S. Chamber of Commerce, and the Business Roundtable, challenged the SEC's implementation of section 1502 by posing three major questions to the court: (1) Is the SEC required to consider whether or not its rule will actually achieve Congress's humanitarian goals?<sup>109</sup> (2) Was the SEC required to adopt a de minimis exception, despite the silence on the issue in the Dodd-Frank language?<sup>110</sup> (3) By requiring disclosure on an issuer's website, has the SEC improperly stigmatized speech and thus run afoul of the First Amendment?<sup>111</sup> Each of these challenges was unsuccessful, and the Conflict Minerals Rule remains on track for implementation in May of 2014.<sup>112</sup>

*1. The SEC Was Not Required to Consider if the Conflict Minerals Rule Would in Fact Achieve Congress's Goals of Defunding Armed Groups in the DRC*

First, the plaintiffs raised several challenges under the Administrative Procedure Act and the Exchange Act, claiming that the SEC failed to uphold its statutory duty to interpret Dodd-Frank.<sup>113</sup> The plaintiffs asserted that the SEC failed to analyze the costs and benefits of the rule "in contravention of its statutory directives under the Exchange Act."<sup>114</sup> Specifically, the plaintiffs urged the court to adopt a standard that would require the SEC to evaluate whether the Conflict Minerals Rule would achieve the humanitarian goals of section 1502.<sup>115</sup> However, the court disagreed, finding that the Exchange Act places no such burden on the SEC.<sup>116</sup> The court cited section 3(f) of the Exchange Act, which only requires the SEC to "consider, in addition to the protection of investors, *whether the action will promote efficiency, competition, and capital formation.*"<sup>117</sup> Additionally, in past precedent, courts have only invalidated an SEC rule where the SEC was "statutorily required" to evaluate the "economic implications" of implementing a new rule.<sup>118</sup> Therefore, the SEC "appropriately deferred to Congress's determination" and was not required to weigh the effectiveness of the new rule on

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<sup>108</sup> *Nat'l Ass'n of Mfrs.*, 956 F. Supp. 2d at 61.

<sup>109</sup> *Id.* at 55–57.

<sup>110</sup> *Id.* at 61.

<sup>111</sup> *Id.* at 73.

<sup>112</sup> *Id.* at 82.

<sup>113</sup> *Id.* at 55–56.

<sup>114</sup> *Id.* at 55.

<sup>115</sup> *Id.* at 55–56.

<sup>116</sup> *Id.* at 56–57.

<sup>117</sup> *Id.* at 56 (emphasis in original).

<sup>118</sup> *Id.* at 57. The court further distinguished this case from past precedent, finding that past decisions invalidated rules where the SEC "of its own accord" identified a market problem and adopted its own rules to regulate the market. *Id.* at 58.

Congress's humanitarian goals.<sup>119</sup> Moreover, the SEC fulfilled its efficiency, competition, and capital information mandate by properly considering the impact and cost of the rule on the industry.<sup>120</sup>

*2. The SEC Was Well Within Its Discretion in Excluding a De Minimis Exception from the Final Conflict Minerals Rule*

The plaintiffs next challenged the SEC's determination that Dodd-Frank did not mandate the adoption of a de minimis threshold exception.<sup>121</sup> The plaintiffs fervently argued that Dodd-Frank required the SEC to adopt a de minimis exception that would exclude issuers whose products are made up of less than 1% of conflict minerals material.<sup>122</sup> The plaintiffs argued that the lack of de minimis language in section 1502 left the decision to create a de minimis exception to the SEC and that the nature of the rule demanded that the SEC include a de minimis exception.<sup>123</sup> The SEC agreed that it had the authority but argued that if the Conflict Minerals Rule were to include a de minimis exception, the rule would inevitably be swallowed up.<sup>124</sup> This is because when conflict minerals are used in products, they are often used in minimal amounts.<sup>125</sup> Therefore, the SEC rejected the exception in an effort to further Congress's disclosure goals. The court agreed, deferring to the SEC. It reasoned that the determination was the "product of reasoned decision-making," upholding the rule on this point.<sup>126</sup>

*3. The SEC Did Not Violate the First Amendment by Requiring Both Regulatory and Public Disclosures of Conflict Mineral Status*

Finally, the plaintiffs asserted that "by compelling companies to publicly state on their own websites . . . that certain of their products are 'not DRC conflict free,'" the Conflict Minerals Rule and section 1502 improperly compels "burdensome and stigmatizing speech" in violation of the First Amendment."<sup>127</sup> The disclosures at issue are the requirements to report, whether through a Form SD or a Conflict Mineral's website, "conflict minerals sourcing practices."<sup>128</sup> The court found that based on the commercial nature of the disclosures, it was required

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<sup>119</sup> *Id.* at 59.

<sup>120</sup> *Id.* at 61 ("While Plaintiffs, again, may disagree, the Court cannot say that the SEC acted arbitrarily or capriciously in reaching this particular estimate.").

<sup>121</sup> *Id.*

<sup>122</sup> *Id.* The plaintiffs argued that the statute neither forbids nor unambiguously forecloses the use of a de minimis exception. *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> *Id.* at 62.

<sup>125</sup> *Id.* at 64.

<sup>126</sup> *Id.* at 66.

<sup>127</sup> *Id.* at 73.

<sup>128</sup> *Id.* at 76.



to apply intermediate scrutiny.<sup>129</sup> The court applied the *Central Hudson Gas & Electric Corp. v. Public Service Commission*<sup>130</sup> intermediate scrutiny standard, which requires (1) an important and substantial government interest; (2) the interest to “directly advance[] the government interest asserted”; and (3) that “the fit between the ends and the means chosen to accomplish those ends is not necessarily perfect, but reasonable.”<sup>131</sup>

The plaintiffs did not contest the first element, recognizing that Congress does have a substantial and important interest in “promoting peace and security in the DRC.”<sup>132</sup> However, the plaintiffs argued that the disclosure requirements are too indirect and lack sufficient empirical support to advance the government’s purported humanitarian and foreign policy interests.<sup>133</sup> The court rejected these arguments because the Supreme Court has found, in the context of foreign relations, that Congress need only act with “informed judgment rather than concrete evidence,”<sup>134</sup> meaning Congress is free to paint with a broader brush in the arena of foreign relations.<sup>135</sup> The court found that Congress acted within its “informed judgment” in concluding that in order to combat the problems in the DRC, the government must shed light on the system that is funding these operations.<sup>136</sup> The plaintiffs also contended that the third prong of the analysis was not met.<sup>137</sup>

Furthermore, the plaintiffs argued that by forcing a company to list products as “not been found to be ‘DRC conflict free,’” the SEC imposes effectively a “scarlet letter” on issuers and there are other less restrictive measures the SEC could undertake to effectuate its goals.<sup>138</sup> The court rejected this contention on many grounds.<sup>139</sup> First, issuers under the Conflict Minerals Rule are merely required to disclose information in a Form SD or CMR.<sup>140</sup> In turn, these reports are then published on the company’s website.<sup>141</sup> Second, no issuer is required to physically label products “not DRC conflict free,” and issuers may clarify or add

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<sup>129</sup> *Id.* at 77 (citing *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n*, 447 U.S. 557, 566 (1980)). The court also hinted that if the disclosures were limited to SEC reporting and not available to the public, through the use of the issuer’s website, rational basis would likely be the reviewing standard. *Id.* at 76–77.

<sup>130</sup> 447 U.S. 557 (1980).

<sup>131</sup> *Id.* at 78.

<sup>132</sup> *Id.*

<sup>133</sup> *Id.*

<sup>134</sup> *Id.* at 79 (quoting *Holder v. Humanitarian Law Project*, 130 S. Ct. 2705, 2727–28 (2010)).

<sup>135</sup> *Id.*

<sup>136</sup> *Id.* at 80.

<sup>137</sup> *Id.* at 81.

<sup>138</sup> *Id.* at 82.

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

additional disclosure if desired.<sup>142</sup> The court found that this was a “reasonable fit” under the *Central Hudson* standard.<sup>143</sup>

The court’s ruling on the Conflict Minerals Rule was a major victory for conflict mineral activists. The celebration could be short lived, however. The case is currently on expedited review to the D.C. Circuit. But whatever the outcome, Dodd-Frank is still good law. The plaintiffs in this action are only seeking to chip away at the SEC’s rule. Therefore, even if the D.C. Circuit overturned part of the rule, it is unlikely that companies will evade conflict mineral disclosure in the future. The arguments in this case are best described as ways of buying the industry time to either change the law or delay implementation until the last possible moment. No matter the outcome of D.C. Circuit case, the normative arguments made in this Note remain—Congress has the power to promulgate disclosure requirements on morality issues. And, in many cases, morality is material.<sup>144</sup>

#### IV. MORALITY IS MATERIAL

So far this Note has provided a look into how Congress is now using the SEC to implement congressional humanitarian goals in the DRC. Many have argued that this is an inappropriate use of the SEC’s delegated congressional authority. Traditionally, the SEC has been the watchdog of financially material information, or, more simply put, information that will affect an investor’s decision making when purchasing securities. It is important to note that the question of “materiality” is moot under the Conflict Minerals Rule because the legislative mandate requires disclosure regardless of materiality.<sup>145</sup> However, the doctrinal question remains: Are human rights and other socially responsible goals a job for the SEC’s disclosure machine? Scholars are concerned that rules like the Conflict Minerals Rule are not aimed at material considerations but rather “underlying

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<sup>142</sup> *Id.* The court also noted that the phase-in period that allows issuers to temporarily label their products as “DRC conflict undeterminable” would help mitigate the plaintiffs’ concerns. *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> As this Note goes to print, the D.C. Circuit is considering the matter. The court heard oral arguments on January 7, 2014. See *Oral Argument Recordings*, U.S. COURT OF APPEALS FOR THE D.C. CIRCUIT, <http://www.cadc.uscourts.gov/recordings/recordings.nsf/DocsByRDate?OpenView&count=100&SKey=201401> (scroll down to “01/07/2014” and select link next to “Natl Assoc. of Manufactures v. SEC” to download recording of oral argument) (last visited Mar. 11, 2014).

<sup>145</sup> In the realm of securities regulation, either information is required under legislative disclosure mandates or a duty to disclose is created through the doctrine of materiality. However, the question of materiality underlies, traditionally, legislative and administrative mandates to disclose. See generally David Monsma & Timothy Olson, *Muddling Through Counterfactual Materiality and Divergent Disclosure: The Necessary Search for a Duty to Disclose Material Non-Financial Information*, 26 STAN. ENVTL. L.J. 137, 144–56 (2007) (reviewing the general framework and explaining the regulations of disclosure requirements).

public policy” goals that are “not necessarily of interest to any investor.”<sup>146</sup> I disagree with this assessment. The Conflict Minerals Rule may effectuate public policy goals, but it also provides information that is inherently material to investors.

To support this proposition, I will first outline, generally, the standard for materiality under our current securities laws. I will then provide two simple arguments: not only are human rights disclosures financially material, but so are the nonfinancial aspects of the Conflict Minerals Rule. While on their face, the humanitarian goals in the DRC do not seem inherently “financial,” human rights violations and a company’s involvement can translate into tort liability, insurance costs, or potential financial penalties related to international labor and humanitarian law violations. These costs, and the risks associated with them, are just as material to an investor as the information on a Form 10-K. Second, the rise of the socially responsible investor has shifted the paradigm away from accounting and financial information, demanding more transparency on issues of human rights and social responsibility. Socially responsible investors will accept lower returns for more humanitarian and socially responsible companies. In other words, a company’s use of DRC conflict minerals will in fact alter the total mix of information and influence how investors will make purchasing decisions. This is the essence of materiality.

#### A. *What is Material?*

The Securities Act of 1933<sup>147</sup> and the Exchange Act of 1934<sup>148</sup> are together the foundation of modern securities regulation. The purpose of these laws is to protect the investing public when investors participate in the securities markets. Materiality is at the “core” of any “legal discussion of disclosure.”<sup>149</sup> When a public company solicits the public for capital, a trade-off occurs. Companies agree to divulge any and all material information in exchange for access to the public marketplace. The SEC’s role and mission in this trade-off is to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”<sup>150</sup> The SEC has traditionally accomplished this goal by being the conduit in which

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<sup>146</sup> David M. Lynn, *The Dodd-Frank Act’s Specialized Corporate Disclosure: Using the Securities Laws to Address Public Policy Issues*, 6 J. BUS. & TECH. L. 327, 330, 354–55 (2011); see also Marcia Narine, *From Kansas to the Congo: Why Naming and Shaming Corporations Through the Dodd-Frank Act’s Corporate Governance Disclosure Won’t Solve a Human Rights Crisis*, 25 REGENT U. L. REV. 351, 391 (2013) (finding that section 1502 was not “designed to protect or inform investors of material information, but rather, to stop a humanitarian crisis”).

<sup>147</sup> 15 U.S.C. § 77a (2012).

<sup>148</sup> *Id.* § 78a.

<sup>149</sup> Monsma & Olson, *supra* note 145, at 142–43.

<sup>150</sup> *Investor’s Advocate*, *supra* note 7 (“The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”)

the investing public receives financially material information.<sup>151</sup> As distilled by the Supreme Court, a material fact is a fact where there is a “substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”<sup>152</sup> Put differently, the material fact would likely influence how an investor would vote and make investing decisions. Commentators have argued that section 1502 does not meet this standard because social and humanitarian responsibility does not bear on the financial condition or economic value of a company.<sup>153</sup> In this next section, I will argue that these critics think too narrowly of the concept of materiality and overlook how the Conflict Minerals Rule fits precisely within the materiality definition.

### *B. The Conflict Minerals Rule Is Inherently Material*

As aforementioned, there are two arguments that the Conflict Minerals Rule represents inherently material information. First, the Conflict Minerals Rule represents real financial consequences for companies engaged in illicit trading practices. Second, socially responsible investing has shifted the traditional materiality definition into nonfinancial factors such as morality.

#### *1. The Conflict Minerals Rule Provides Investors with Material Information that Directly Weighs on the Profitability of a Company*

The Conflict Minerals Rule is related to the financial and economic stability of a company. When a company engages in risky trade practices, like the transport and trade of conflict minerals, the issuer exposes the company purse to tort liability, insurance costs, and potential penalties for violating international labor and humanitarian laws.<sup>154</sup> For example, the Center for Constitutional Rights (CCR) has successfully sued numerous U.S. companies, in U.S. courts, for human rights violations around the globe.<sup>155</sup> One example is *Doe I v. Unocal Corp.*,<sup>156</sup> where CCR reached a settlement with Unocal Corporation for its human rights violations

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<sup>151</sup> See *id.*

<sup>152</sup> *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (citations omitted).

<sup>153</sup> See, e.g., Woody, *supra* note 9, at 1340–42 (“[D]isclosure of social and environmental information is typically not required because that information, to date, has not been regarded as relevant or material to the financial condition of a company.”).

<sup>154</sup> See Eric Engle, *What You Don’t Know Can Hurt You: Human Rights, Shareholder Activism and SEC Reporting Requirements*, 57 SYRACUSE L. REV. 63, 83–84 (2006).

<sup>155</sup> See CTR. FOR CONSTITUTIONAL RIGHTS, CORPORATE HUMAN RIGHTS ABUSE 3 (2014), available at [http://ccrjustice.org/files/CCR\\_Corp.pdf](http://ccrjustice.org/files/CCR_Corp.pdf).

<sup>156</sup> 395 F.3d 932 (9th Cir. 2002), *vacated* 403 F.3d 708 (9th Cir. 2005) (en banc) (dismissing the panel decision and vacating the district court decision on stipulated motion).

in Burma.<sup>157</sup> There, four Burmese citizens sued under the Alien Tort Statute (ATS) for human rights violations, assault, forced labor, wrongful death, intentional infliction of emotional distress, and imprisonment because of the company's involvement in the Myanmar gas pipeline.<sup>158</sup> The Burmese military surrounding the pipeline project had committed these crimes against the Burmese citizens.<sup>159</sup>

Another potential financial liability a corporation may face is violation of international pillaging law.<sup>160</sup> Pillaging law prohibits theft such as looting, spoliation, and plundering during war and other armed conflicts.<sup>161</sup> Some scholars suggest that the law of pillaging is an avenue to hold corporate actors criminally liable for taking advantage of unstable situations, like that in the DRC, for the exploitation of natural resources.<sup>162</sup> As investors learn about these risk factors associated with human rights violations, including ATS liability and pillaging laws, investors will recognize that “non-compliance represents a significant and largely preventable financial risk, and thus alter their investment patterns accordingly.”<sup>163</sup>

The Conflict Minerals Rule can be juxtaposed with disclosure guidance adopted by the SEC in 2010 that requires companies to disclose how their business practices affect climate change.<sup>164</sup> The general motivation behind the SEC issuing disclosure guidance was that investors had the right to know whether issuing firms faced significant environmental regulation and potential litigation liabilities.<sup>165</sup> In

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<sup>157</sup> Recently, however, the Supreme Court significantly raised the bar for victims of human rights violations to sue in federal court. *See* *Kiobel v. Royal Dutch Petroleum Co.*, 133 S. Ct. 1659, 1665 (2013). But there remains a significant scholarly discussion as to *Kiobel*'s real effect. *See, e.g.*, Jonathan Hafetz, Essay, *Human Rights Litigation and the National Interest: Kiobel's Application of the Presumption Against Extraterritoriality to the Alien Tort Statute*, 28 MD. J. INT'L L. 107, 108 (2013) (“[E]ven as *Kiobel* imposes a new territorial nexus requirement, it leaves open the possibility that some consideration may be given in future cases to how ATS suits advance U.S. interests in determining whether the presumption against extraterritoriality is displaced.”). Additionally, many agree that *Kiobel* has simply shifted the venue for human rights activities to arenas like state court. *See, e.g.*, Christopher A. Whytock et al., *Forward: After Kiobel—International Human Rights Litigation in State Courts and Under State Law*, 3 U.C. IRVINE L. REV. 1, 5 (2013) (“[I]f substantive and procedural barriers to human rights litigation under U.S. federal law in the U.S. federal courts continue to grow, plaintiffs alleging human rights violations are increasingly likely to consider pursuing their claims in state courts or under state law.”).

<sup>158</sup> *Doe I*, 395 F.3d at 937–45.

<sup>159</sup> *Id.*

<sup>160</sup> JAMES G. STEWART, PROSECUTING THE PILLAGE OF NATURAL RESOURCES 75–82 (2011), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1875053](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1875053).

<sup>161</sup> *Id.* at 15–17.

<sup>162</sup> *See, e.g., id.* at 75–82.

<sup>163</sup> Engle, *supra* note 154, at 89.

<sup>164</sup> *See* Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6,290, 6,293 (Feb. 8, 2010) (to be codified at 17 C.F.R. pts. 211, 231, & 241).

<sup>165</sup> *Id.* at 6,291.

this instance, the SEC responded to investors who felt that companies were not providing enough data on the potential risks to their profits and operations from environmental protection laws.<sup>166</sup> Similarly, one can view the Conflict Minerals Rule as Congress's recognition of not only the humanitarian benefits of disclosure, but also of the benefits that will be realized by investors seeking materially relevant information. Admittedly, the Dodd-Frank statutory language is divorced of any language hinting at investor materiality.<sup>167</sup> However, Congress arguably used the SEC to effectuate this goal because Congress understood that conflict mineral information would be material to investors and would incite change in market behavior. The SEC recognized this underlying motivator in the rule release, finding that the Conflict Minerals Rule will "provide information that is material to an investor's understanding of the risks in an issuer's reputation and supply chain."<sup>168</sup> Additionally, one commentator noted that the benefits of the Conflict Mineral Rule would eliminate

competitive disadvantage to companies already engaged in ensuring their conflict mineral purchases do not fund conflict in the DRC, providing an opportunity to improve a company's existing risk management and supply chain management, stimulating innovation, supporting companies' requests for conflict minerals information from suppliers through legal mandate, and preparing companies to meet a new generation of expectations for greater supply chain transparency and accountability.<sup>169</sup>

Therefore, the Conflict Minerals Rule arguably presents investors with financial information that is just as potent as any other SEC filing.

## *2. The Nonfinancial Moral Factors of the Conflict Minerals Rule Are Material to Investors*

Aside from being financially relevant, the Conflict Minerals Rule also implicitly recognizes the undercurrent of important nonfinancial material information in the marketplace. Socially responsible investing has been on the rise

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<sup>166</sup> See Jim Efstathiou Jr., *SEC Sets Corporate Climate-Change Disclosure Standard (Update1)*, BLOOMBERG (Jan. 27, 2010, 1:47 PM), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aPXp9qdIIIhg>.

<sup>167</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1502, 24 Stat. 1376, 2213-18 (2010).

<sup>168</sup> Conflict Minerals, 77 Fed. Reg. 56,274, 56,276 (Sept. 12, 2012) (to be codified at 17 C.F.R pts. 240 & 249b).

<sup>169</sup> *Id.* at 56,279. IBM is an example of a firm that has embraced the Conflict Minerals Rule, recognizing the competitive advantage of supply chain accountability. See IBM, 2012 CORPORATE RESPONSIBILITY REPORT 126 (2012) ("[IBM] understand[s] the importance of achieving a supply chain that uses only responsibly sourced minerals."), available at <http://www.ibm.com/ibm/responsibility/2012/supply-chain/conflict-minerals.html>.

for years.<sup>170</sup> Investors are increasingly relying on “social, environmental, and governance” information, or what has been called “SEG” information, to make investing decisions.<sup>171</sup> Investors are already using SEG information to “decide proxy votes,” “screen mutual funds,” and make “investment related decisions.”<sup>172</sup> These investors make investment decisions with SEG information that “is clearly material to them, irrespective of its economic implications.”<sup>173</sup> Professor David Monsma argues, “In a world where social and environmental risks play a greater role in investor decisions . . . materiality expands to encompass these risks and thereby creates a new legal threshold for disclosure.”<sup>174</sup>

Arguably, many investors, not just socially responsible investors, will be hesitant to invest in organizations that are funding rape, murder, and starvation in the DRC.<sup>175</sup> These motivators are not financial, but moral, and carry with them the power to profoundly shape how investors make purchasing decisions. However, scholars caution that it will be difficult going forward to draw a line regarding the “use of the public disclosure system contemplated by the federal securities laws for the purposes of addressing social, public policy, and geo-political concerns.”<sup>176</sup> I believe this concern is misguided. Line drawing will occur naturally in the marketplace. For example, arguably not every humanitarian or social issue will rise to the level of materiality. Investors will examine the severity of the crisis and, most importantly, the strength of the relationship between the humanitarian harm and the corporate involvement. The stronger this relationship is, the more severe the harm and the more likely investors will find the information material and demand company disclosure. In section 1502, Congress has simply codified a market need that has already been set in motion. Increasingly, issuers have begun to volunteer SEG information—recognizing that investors want more than financial information when investing.<sup>177</sup> The threat of investor accountability created by the Conflict Minerals Rule will change trade practices in the DRC through investors’ access to new information. Whether or not the change will bring peace to the Congolese people is the subject for another article. What is relevant is

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<sup>170</sup> The Forum for Sustainable and Responsible Investment estimates that as of 2012, there is over \$3.74 trillion in assets managed according to SEG criteria; this is a 22% increase since the end of 2009. See US SIF, REPORT ON SUSTAINABLE AND RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES 11 (2012), available at [http://www.ussif.org/files/Publications/12\\_Trends\\_Exec\\_Summary.pdf](http://www.ussif.org/files/Publications/12_Trends_Exec_Summary.pdf).

<sup>171</sup> Monsma & Olson, *supra* note 145, at 143.

<sup>172</sup> *Id.* at 160.

<sup>173</sup> Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1288–89 (1999).

<sup>174</sup> Monsma & Olson, *supra* note 145, at 199.

<sup>175</sup> *Supra* section II.B.

<sup>176</sup> Lynn, *supra* note 146, at 339.

<sup>177</sup> Engle, *supra* note 154, at 84; see also Amol Mehra, *More than CSR: The Benefits of Conflict Minerals Disclosure to Business and Investors*, FORBES (May 9, 2012, 6:37 PM), <http://www.forbes.com/sites/csr/2012/05/09/more-than-csr-the-benefits-of-conflict-minerals-disclosure-to-business-and-investors/>.

that this information, while not financial, is material, and I believe we will continue to see Congress and the SEC demand more socially responsible disclosures in the future.

#### V. CONCLUSION

The Conflict Minerals Rule is an appropriate use of the SEC's disclosure power. Issues of morality that arise in a humanitarian crisis like that in the DRC are inherently material. The takeaway from this discussion is that U.S. companies cannot ignore the paradigm shift that is occurring in securities regulation. Congress will continue to use the powerful reporting mechanism of the SEC to require disclosures of nonfinancial material information like the illicit trade in the DRC. Whether the DRC will reap the benefits of these disclosures remains to be seen.