COMMENTS

of

THE WASHINGTON LEGAL FOUNDATION

to the

SECURITIES AND EXCHANGE COMMISSION

Concerning

PROPOSED RULES FOR IMPLEMENTING THE CONFLICT MINERALS REPORTING REQUIREMENTS OF SECTION 1502 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (RELEASE NO. 34-63547; FILE NO. S-7-40-10)

IN RESPONSE TO THE COMMISSION'S INVITATION TO SUBMIT WRITTEN COMMENTS

Daniel J. Popeo
Cory L. Andrews
WASHINGTON LEGAL FOUNDATION
2009 Massachusetts Ave., NW
Washington, DC 20036

March 30, 2011

Washington Legal Foundation
2009 Massachusetts Ave., N.W.
Washington, D.C. 20036
(202) 588-0302

March 30, 2011

Via Electronic Mail
Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Proposed Rules for Implementing the Conflict Minerals Reporting Requirements of Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Ms. Murphy:

The Washington Legal Foundation (WLF) hereby submits these comments to Chairman Schapiro and the Commissioners in response to the request by the Securities and Exchange Commission (the "Commission") for input on proposed rules implementing the Conflict Minerals Reporting Requirements of Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

I. *Interests of WLF*

The Washington Legal Foundation (WLF) is a non-profit, public interest law and policy center based in Washington, D.C., with supporters nationwide. Founded 34 years ago, WLF regularly appears before federal and state courts and administrative agencies to promote economic liberty, free enterprise, and a limited and accountable government. WLF has a longstanding interest in the work of the SEC, especially as it relates to several of WLF's comprehensive goals. These include protecting the stock markets from manipulation; protecting employees, consumers, pensioners, and investors from stock losses caused by abusive securities and class action litigation practices; encouraging congressional and regulatory oversight of the conduct of the plaintiffs' bar with respect to the securities industry; and restoring investor confidence in the financial markets through regulatory and judicial reform measures. Additional background information on WLF is available on our website at *www.wlf.org*.

Over the years, WLF has filed several complaints with the SEC requesting formal investigation of instances where there appeared to be a manipulation of the price of a stock by

short sellers who were collaborating with class action and plaintiffs' attorneys. On May 22, 2003, WLF testified before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises of the Committee on Financial Services for the U.S. House of Representatives on "The Long and Short of Hedge Funds: Effects and Strategies for Managing Market Risk: The Relationship Between Short Sellers and Trial Attorneys."

WLF has filed a number of comments with the SEC on matters of public interest. For example, on September 18, 2006, WLF filed comments in File No. S7-11-06: Concept Release Concerning Management's Reports on Internal Control Over Financial Reporting Under Sarbanes-Oxley. WLF also filed comments on May 20, 2008 in File no. S7-08-08: SEC's Proposed "Naked" short Selling Anti-Fraud Rule, 73 Fed. Reg. 15376 (March 21, 2008). Most recently, WLF filed comments on

WLF also litigates and appears as amicus curiae before federal courts in cases involving securities litigation. *See, e.g., Morrison v. Nat'l Australia Bank Ltd.*, 130 S. Ct. 2869 (2010); *Merck & Co. v. Reynolds*, 129 S. Ct. 2432 (2009); *Stoneridge Inv. Partners LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008); *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006); *Dura Pharm, Inc. v. Broudo*, 544 U.S. 336 (2005).

Similarly, WLF's Legal Studies Division has produced and distributed timely publications on securities regulations and the SEC. WLF's most recently published works in this area include: William G. Lawlor and Michael L. Kichline, *Federalizing Fiduciary Duties Through Shareholder Lawsuits: Three Reasons for Court Scrutiny* (WLF Working Paper, July 23, 2010); Tammy Albarran, *Court Reins In SEC's Expansive "Primary Liability" Theory* (WLF Legal Opinion Letter, June 18, 2010); and, Laura L. Flippin and Morgan J. Miller, *Double Teamed: Defending Parallel Investigations Under SEC's New Cooperation Initiative* (WLF Legal Backgrounder, April 23, 2010).

Comments of WLF

1. Section 1502 Raises Legitimate First Amendment Concerns.

Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), enacted on July 21, 2010, requires publicly traded companies to investigate the sources of minerals used in their products. The purpose of this requirement is to diminish purchases of conflict minerals and to require covered companies to publicly disclose information about their investigations to the SEC and the public. Because a principal reason for the required conduct (investigating and auditing) is to obtain information that is then the subject of compelled speech (SEC reports), the requirements may be open to a First

Amendment challenge.

The right to speak freely on matters of public importance includes the right ***not*** to be compelled to speak about such matters. *Riley v. National Federation of the Blind of North Carolina, Inc.*, 487 U.S. 781, 796 (1988). The burden of defending the Conflict Minerals Disclosures from a First Amendment challenge rests on the federal government, and the extent of that burden will depend on whether the disclosures are determined to be on matters of public interest (strict scrutiny) or "commercial speech" (intermediate scrutiny).

The mandatory Conflict Mineral Disclosures most likely do not qualify as commercial speech. According to the Supreme Court, speech may properly be characterized as commercial speech only where (1) it is concededly an advertisement, (2) it refers to a specific product, or (3) it is motivated by an economic interest in selling the product. *Bolger v. Youngs Drug Prods. Corp.*, 463 U.S. 60, 66-67 (1983). Conflict Minerals Disclosures are not commercial speech, since these disclosures neither propose a transaction with potential investors nor relate exclusively to the economic interests of issuers and potential investors.

Under the strict scrutiny standard, a law restricting or compelling speech is presumptively invalid. *R.A.V. v. St. Paul*, 505 U.S. 377, 382 (1992). The Government must show that: (a) the interest the government proffers in support of the law is "compelling;" (b) the ills the government claims actually exist and the law will materially reduce them; and (c) less restrictive alternatives would not comparably accomplish the government's goals. *Blount v. S.E.C.*, 61 F.3d 938, 944 (D.C. Cir. 1995). While the interest proffered in support of the Conflict Minerals Disclosures (an emergency humanitarian crisis) would likely be considered compelling, the government would have a difficult time showing that requiring only certain companies (i.e., publicly traded issuers) to make the disclosures will materially reduce the crisis. This is particularly so in light of the equivocal language found in Section 1502:

a. "It is the **sense of Congress**" that the trade of conflict minerals is "helping" and "contributing" to the crisis;
b. The Secretary of State is to develop a "strategy" to "address the linkages" between the crisis, the mining of conflict minerals, and commercial products; and
c. The Comptroller General is to assess and report on the "effectiveness" of the Conflict Minerals Disclosures in addressing the crisis.

In other words, Section 1502 is merely a test to determine ***whether*** disclosures will actually further the stated governmental interest. The government would have a difficult time meeting its burden to show that the humanitarian crisis cannot be addressed more directly without implicating speech.

Even if Conflict Minerals Disclosures are determined to be commercial speech and, therefore, subject to the intermediate standard of review, the burden remains on the government to defend them under the First Amendment. This, in turn, means showing that the regulations **directly** advance a compelling governmental interest and are no more extensive than necessary to serve that interest. This burden "is not satisfied by mere speculation or conjecture; rather, a governmental body seeking to sustain a restriction on commercial speech must demonstrate that the harms it recites are real and that its restriction will in fact alleviate them to a material degree." *Fla. Bar v. Went For It, Inc.*, 515 U.S. 618, 625-26 (1995). Further, if the government could achieve its interests in a manner that does not regulate speech (or that regulates less speech), the government must do so. *See Thompson v. Western States Medical Center*, 535 U.S. 357 (2002). For the same reasons that the Conflict Minerals Disclosures should fail a strict scrutiny analysis, the government would likely be unable to meet its burden.

2. The SEC Has A Statutory Obligation To Apprise Itself Of The Economic Consequences Of Any Proposed Regulation.

The SEC extended the time for public comment concerning the Conflict Mineral Disclosures but has not yet issued final regulations. Adoption of these proposed regulations would be arbitrary and capricious if the agency "entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or it is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). When responding to rulemaking comments, an agency must respond in a reasoned manner to those that raise significant problems. *Covad Commc'ns Co. v. FCC*, 450 F.3d 528, 550 (D.C. Cir. 2006).

The SEC has a statutory obligation to apprise itself of the economic consequences of the proposed regulations. *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005). WLF has reviewed the public comments to the SEC on the Conflict Minerals Disclosures and found most public comments to be emotional expressions of support for the regulation of conflict metals. WLF generally supports the vital human rights objectives of Section 1502, but serious questions remain as to the SEC's focus on the issues relating to the economic consequences and financial impact of the regulations.

The Securities Exchange Act of 1934 ("Exchange Act") also requires that, in making rules and regulations, the SEC must consider "the impact any such rule or regulation would have on competition" and "shall not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of this chapter." 15 U.S.C. § 78w(2). WLF has not seen much meaningful discussion in the

comments about the impact on competition, and questions whether the SEC is complying with its mandate to both consider competition and limit the regulations' anticompetitive impact to only what is necessary or appropriate to further the purposes of the Exchange Act.

3. The Proposed Rules Create A Competitive Disadvantage For U.S. Companies.

Section 1502 applies only to those companies required to file periodic reports with the SEC and that require certain minerals to manufacture their products. The industries affected by the proposed rule are varied and include manufacturers of jewelry, computers, mobile telephones, digital camera, videogame consoles, and other electronic equipment. Yet the law does not require the federal government to publicly reveal the names of foreign and private companies whose products contain conflict minerals but who have failed to disclose this information. Rather, Section 1502 requires that the Comptroller General prepare and deliver to Congress an annual report containing a "general review" of foreign and private companies whose products contain conflict minerals and whether these entities are publicly disclosing such use.

Because domestic publicly traded companies are required to report exhaustively detailed data on their own company website per Section 13 of the Securities and Exchange Act of 1934, the federal government is giving foreign companies a competitive advantage over domestic companies—at a time when the need for economic growth has never been greater. By requiring only a general review of foreign companies that will not be made public, the law places U.S. companies at a competitive disadvantage, since their products will sit on shelves next to foreign products labeled "conflict free." In order for U.S. companies to compete on a level playing field, foreign companies should be required to provide the same public disclosure required of domestic companies.

Conclusion

For the foregoing reasons, WLF urges the Commission to take all steps necessary to reduce the regulatory burden on the nation's public companies of complying with the proposed rules implementing the conflict minerals reporting requirements of Dodd-Frank. The Commission should familiarize itself with the important constitutional issues surrounding compelled speech and work to ensure that the free speech rights of American businesses are not compromised. At the same time, the Commission should do everything in its power to to apprise itself of the economic consequences of the proposed regulations. And finally, the Commission's rules should not allow for foreign companies to gain an unfair competitive advantage over American firms. WLF appreciates the opportunity to submit these comments

and thanks the Commission for the opportunity to provide meaningful feedback.

Respectfully submitted,

/s/ Cory L. Andrews

Daniel J. Popeo
Chairman and General Counsel

Cory L. Andrews
Senior Litigation Counsel