April 4, 2011

MEMORANDUM TO: Jonathan J. Rusch, Chair
ABA Section of Administrative Law and Regulatory Practice

FROM: William J. Williams, Jr.

RE: Dodd-Frank §§ 1502-04

Dear Mr. Rusch:

I don't know the scope of the term "administrative law" or the interests of the ABA's Section of Administrative Law and Regulatory Practice. Accordingly, I don't know whether your Section would be interested in the problem when Congress uses existing statutes and their administrative agency as a vehicle to accomplish new and very different ends unrelated to their fundamental purpose.

In 1933 and 1934, Congress enacted the Securities Act and the Exchange Act for the purpose of protecting investors in securities. It imposed on issuers subject thereto disclosure obligations and liabilities for failure to disclose material required information, material misstatements and materially misleading statements. "Material" is not defined in the statutes but has been defined by the SEC and the courts in terms of what a reasonable investor would consider important in determining whether to purchase or sell a security. Liabilities are imposed based on damages incurred in purchasing or selling securities.

In §§ 1502-04 of Dodd-Frank, Congress has imposed on reporting issuers new obligations to include in their Exchange Act reports information with respect to "conflict minerals" originating in the Democratic Republic of the Congo (§ 1502), mine safety (§ 1503) and payments by resource extraction issuers (§ 1504). As a result, these provisions subject reporting issuers to liabilities under the Securities Act and Exchange Act in respect of the new information. They also impose on the SEC an obligation to administer these requirements and compliance thereunder without providing the SEC with additional funds for staffing and systems.

Sections 1502-04 address a purpose that is fundamentally different from the purposes underlying the existing disclosure regime under the Securities Act and the Exchange Act. They are intended to achieve humanitarian objectives by affecting conduct, not to protect investors through disclosure. Some of the information required by §§ 1502-04 may be material to the investors and, as a result, already required to be disclosed to investors, but much of the required information will be of no interest to investors.

Under Exchange Act § 18, any person who makes or causes to be made in any report filed with the SEC any statement that is false or misleading with respect to any material fact is liable in damages to any person who, in reliance thereon, purchases or sells a security at a price affected by the statement. Exchange Act reports that are filed with the SEC are incorporated by reference in registration statements under the Securities Act relating to public offerings. Under Securities Act § 11, an issuer is <u>absolutely liable</u> (i.e., without defense) if the registration statement (including the incorporated reports) contains an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading. All directors, signing officers and underwriters are also liable unless they can affirmatively prove that they made a reasonable investigation and were not aware of the deficiency (sometimes referred to as the "due diligence" defense). Under Securities Act § 12(a)(2), persons who use the prospectus contained in the registration statement (including incorporated reports) to sell securities are liable unless they can prove that they did not know of any untruth therein or omission therefrom and, in the exercise of reasonable care, could not have known of the untruth or omission. Sections 11 and 12 provide for relief in damages or rescission relating to the purchased security. How do these provisions apply to deficiencies in information relating to conflict minerals, mine safety or payments by resource extraction issuers? Presumably, no liability if the deficiencies are not of significance to investors in making their investment decisions. But the courts may, unnecessarily, have to spend time dealing with this issue.

That you may know that Section 1504 at least was not a result of Congressional inadvertence but rather malice (aforethought or afterthought), I attach a copy of a letter from Senators Cardin, Kerry, Leahy and Schumer and Congressman Frank to the SEC commenting on its proposed implementation of Section 1504.

I take no position on whether §§ 1502-04 usefully advance the humanitarian purposes intended. But I do think that if those disclosures are going to be required, they should be lodged with a more logical government agency, perhaps the Commerce Department, to administer – with more suitable timing requirements, public visibility beyond the investor community and a liability regime that fits the circumstances.

I attach for your information comment letters relating to implications of Dodd-Frank §§ 1502-04 submitted to the SEC by the Securities Regulation Committee, Business Law Section, of the New York State Bar Association. They do not address the broad concerns I have expressed above but do illustrate the problems of trying to harmonize two very different statutory regimes.

I would like to make clear that I am addressing this to you in my capacity as an active member of the Business Law Section's Federal Regulation of Securities Committee and not as a member of the ABA's Task Force on Financial Markets Regulatory Reform.

Thank for your attention to this. If you have any questions, please feel free to communicate with me at (212) 558-3722 or williamsw@sullcrom.com.

W.J.W., Jr.



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