

AMERICAN BAR ASSOCIATION
ADOPTED BY THE HOUSE OF DELEGATES
FEBRUARY 14, 2011

RESOLUTION

RESOLVED, That the American Bar Association urges Congress to amend clause (A) of Subsection (2) of Section 13(p) of the Securities Exchange Act of 1934 (15 U.S.C. § 78m(p)) to read in its entirety as follows: “the person is a registrant that files reports with the Commission under Sections 13(a) (15 U.S.C. 78m(a)) or 15(d) (15 U.S.C. 78o(d)) of the Securities Exchange Act of 1934, and”

REPORT

This report addresses a significant deficiency in the language of section 1502 of the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act¹ (Dodd-Frank). That section sets forth new reporting requirements stemming from the ongoing armed conflict in the Democratic Republic of the Congo (Congo). Unfortunately, that section's definition of the entities subject to these reporting requirements raises important issues of due process and fair notice because it is so vague and circular.

For the past fifteen years, Congo has been experiencing a humanitarian crisis that, according to the International Rescue Committee,

is among the most complex, deadly and prolonged ever documented. The wars of 1996 and 1998 resulted in massive disruption to the social, political and economic fabric of the country. The second war officially ended in December 2002 but has since given way to several smaller conflicts in the five eastern provinces that continue to exact an enormous toll on the lives and livelihoods of the Congolese people.²

In the eastern region of the Congo, rebel militias and even some government soldiers have been obtaining funding for firearms and other support “through the sale of mineral ore containing tantalum, tungsten, tin and gold. For example, tantalum from Congo is used to make electrical capacitors that go into phones, computers and gaming devices.”³ Other minerals mined in the region include “cassiterite (used in laptops), coltan (mobile phones) and wolframite (light bulbs).”⁴ By tactics that include widespread rape and murder of civilians and burning of villages, rebels intimidate civilians into mining these minerals for the rebels’ use in selling and exporting these minerals, sometimes relabeled as products of neighboring nations such as Uganda.⁵ The financial support that the groups receive from the mining and sale of

¹ Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

² Nicholas D. Kristof, *Death by Gadget*, New York Times, June 26, 2010, available at <http://www.nytimes.com/2010/06/27/opinion/27kristof.html>.

³ Editorial, *Congo's conflict minerals*, Los Angeles Times, July 26, 2010, available at <http://articles.latimes.com/2010/jul/26/opinion/la-ed-congo-20100726>.

⁴ *Congo's conflict minerals: Clean them up*, The Economist, August 19, 2010, available at <http://www.economist.com/node/16846816>.

⁵ See *How Gold Pays For Congo's Deadly War*, 60 Minutes, November 29, 2009, available at http://www.cbsnews.com/stories/2009/11/25/60minutes/main5774127_page3.shtml?tag=contentMain;contentBody.

conflict minerals is substantial. According to *The Economist*, “The export of illicit gold alone is reckoned to be worth \$1.2 billion a year, almost none of it accruing to Congo’s treasury”⁶

As one approach to addressing the problem of Congo conflict minerals, section 1502 of Dodd-Frank amended section 13 of the Securities Exchange Act of 1934 (Exchange Act) by adding a new subsection (p). This subsection created a detailed regime for disclosure regarding Congo conflict minerals to the Securities and Exchange Commission (SEC). In brief, subsection 13(p)(1)(A) directs the SEC, no later than 270 days after the date of enactment (i.e., July 21, 2010), to promulgate regulations requiring “any person described in paragraph [13(p)](2)” to make annual disclosures as to whether conflict minerals that are “necessary to the functionality or production of a product manufactured by such person”⁷ “did originate in the Democratic Republic of the Congo or an adjoining country.”⁸ In cases in which such conflict minerals originated in any such country, subsection 13(p) further requires that the person submit to the SEC a report that includes:

(i) a description of the measures taken by the person to exercise due diligence on the source and chain of custody of such minerals, which measures shall include an independent private sector audit of such report submitted through the Commission that is conducted in accordance with standards established by the Comptroller General of the United States, in accordance with rules promulgated by the Commission, in consultation with the Secretary of State; and

(ii) a description of the products manufactured or contracted to be manufactured that are not DRC conflict free (‘DRC conflict free’ is defined to mean the products that do not contain minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country), the entity that conducted the independent private sector audit in accordance with clause (i), the facilities used to process the conflict minerals, the country of origin of the conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity.⁹

The person making the report would also be required to certify the audit described in clause (i) of subparagraph 13(p)(1)(A) above. Subsection 13(p) specifically states that such a certified

⁶ *Congo’s conflict minerals*, *supra* note 3.

⁷ 15 U.S.C. § 78m(p)(2)(B).

⁸ *Id.* § 78m(p)(1)(A).

⁹ *Id.* § 78m(p)(1)(A).

audit “shall constitute a critical component of due diligence in establishing the source and chain of custody of such minerals.”¹⁰

A key issue for application of subsection 13(p) is how it defines the class of persons that is subject to its requirements. In this regard, subsection 13(p) contains a critical flaw. Subsection 13(p)(1)(A) states that the contemplated SEC regulations shall impose this disclosure obligation on “any person described in paragraph [13(p)](2).”¹¹ Subsection 13(p)(2), however, states that a person is described in paragraph 13(p) if “(A) the person is required to file reports with the Commission pursuant to paragraph (1)(A); and (B) conflict minerals are necessary to the functionality or production of a product manufactured by such person.”¹² Therefore, subsection 13(p)’s definition of “person” is virtually circular, notwithstanding that subsection 13(p) does refer to conflict minerals being necessary to the functionality or production of a product that such person manufactures. Therefore, as to the definition of “person”, nothing on the face of subsection 13(p) gives the SEC, the State Department, or private-sector entities any meaningful guidance about the intended scope of coverage of its requirements. This leaves the SEC, the State Department, and private-sector entities in the difficult position of construing and applying a critical statutory term that is vague on its face.

Because the term “person” is included within the provisions of the Exchange Act, one possible construction of the term “person” in subsection 13(p) would be to use the Exchange Act’s general definition of “person” as “a natural person, company, government, or political subdivision, agency, or instrumentality of a government.”¹³ Under this reading, any natural or corporate person would come within the scope of subsection 13(p) if he, she, or it manufactured any product for which one or more conflict minerals were necessary to the functionality or production of that product. Such an expansive definition would potentially include not only computer and cellphone manufacturers, such as Apple, Intel, and Research in Motion (maker of the BlackBerry),¹⁴ but individual goldsmiths and small-scale makers of jewelry or tin soldiers, regardless of whether those individuals were in fact prospective or actual issuers of securities subject to SEC authority.

A factor that strongly militates against this reading is that the SEC’s authority under the Exchange Act is not commonly understood to encompass all commercial or industrial activity,

¹⁰ *Id.* § 78m(p)(1)(B).

¹¹ *Id.* § 78m(p)(1)(A).

¹² *Id.* § 78m(p)(2).

¹³ 15 U.S.C. § 78c(a)(9).

¹⁴ See Kristof, *supra* note 1.

even manufacturing activity, in the absence of some nexus to the regulation of securities and issuers thereof. As courts have commonly recognized, the purpose of the Exchange Act is to eliminate serious abuses in a largely unregulated securities market,¹⁵ protect investors against manipulation of stock prices, and impose regular reporting requirements on companies whose stock is listed on national securities exchanges.¹⁶ Consistent with that view, the term “person” is typically employed in the Exchange Act to define a natural person or other entity that is engaging in some action related to the activity of securities markets or to investors in securities (e.g., prohibitions on market manipulation).¹⁷ To conclude that the SEC’s authority under subsection 13(p) extends to categories of natural and corporate persons that are not “issuers” or who are not otherwise routinely covered under the Exchange Act would be possible only by drastically expanding current constructions of the Exchange Act’s intended purpose.

Another possible construction of the term “person” in subsection 13(p) would be to interpret that term as limited only to issuers of securities whose activities are otherwise covered by the Exchange Act. This, at least, would be consistent with the purpose of the Exchange Act, and would substantially reduce the number of entities that would be expected to make such annual disclosures. But Congress clearly did not adopt other terms of art from the Exchange Act, such as “issuers,” that would indicate its intent to limit the scope of subsection 13(p) in that way.

It is a basic principle of due process that people “cannot be expected to guess at the meaning of [an] enactment.”¹⁸ At present, both the SEC and the manufacturing sector, as well as retail industries dependent on manufacturing, can only guess as to what Congress meant when it adopted the circular definition of “person” in subsection 13(p). Ambiguity and vagueness, however, are critical flaws when violations of subsection 13(p) and the prospective SEC regulations thereunder, like other sections of the Exchange Act, may be subject to both civil and criminal sanctions. With respect to civil enforcement, the SEC can bring actions to enforce any provision of the Exchange Act in federal district court under section 21(d) of the Exchange Act,¹⁹ or administratively under section 21C of the Exchange Act.²⁰ With respect to criminal

¹⁵ See *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).

¹⁶ See, e.g., *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976).

¹⁷ See 15 U.S.C. § 78i.

¹⁸ *Winters v. New York*, [333 U.S. 507](#), 515-16 (1948).

¹⁹ 15 U.S.C. § 78(u)(d)(1).

²⁰ 15 U.S.C. § 78u-3.

enforcement, anyone who willfully violates any provision of the Exchange Act or rules or regulations thereunder may be subject to criminal prosecution under subsection 32(a) of the Exchange Act²¹ that could result in imprisonment for up to 10 years and a \$1 million fine. In these circumstances, any effort to enforce the provisions of subsection 13(p) could encounter serious challenges on vagueness and due process grounds.

If it expects the disclosure provisions of subsection 13(p) to be effectively implemented, and to have the greatest effect in discouraging the future use of Congo conflict minerals by U.S. manufacturers, Congress should revise the definition of “person” in that subsection to clearly state the categories of “person” it intends to cover. The best way to do so would be to define “person” in subsection 13(p)(2)(A) as “an issuer with securities registered under section 12 of the Exchange Act.” That phrase has two distinct benefits. First, it involves language that is widely used and understood in securities regulation. As a result, Congressional adoption of that language would constitute a far clearer delegation of authority to the SEC and eliminate obvious ambiguities in the scope of that delegation. Second, adoption of language consistent with the statutory text and construction of the Exchange Act would make it substantially easier for both the SEC, in carrying out its regulatory responsibilities under subsection 13(p), and manufacturing entities, in seeking to comply with subsection 13(p), to determine whether the subsection 13(p) requirements pertain to specific business entities. This revision of the definition of “person” in subsection 13(p) would therefore serve to promote the timely achievement of the goals underlying that section.

For these reasons, the American Bar Association urges Congress to amend subsection 13(p) of the Securities Exchange Act of 1934 to define a person subject to the requirements of that subsection as “an issuer with securities registered under Section 12 of the Exchange Act.”

Respectfully submitted,

Jonathan J. Rusch
Chair, Section of Administrative Law and Regulatory Practice
February 2011

²¹ 15 U.S.C. § 78ff(a).

GENERAL INFORMATION FORM

Submitting Entity: Section of Administrative Law and Regulatory Practice
Submitted by Jonathan J. Rusch, Chair of the Section of Administrative Law and Regulatory Practice

1. Briefly summarize the recommendation

The recommendation urges Congress to revise the definition of “person” in subsection 13(p) of the Securities Exchange Act of 1934 (15 U.S.C. § 78m(p)) to define a person subject to the requirements of that subsection as “an issuer with securities registered under section 12 of the Exchange Act”.

2. Indicate whether the recommendation was approved or will be considered, the governing body of the submitting entity which has approved or will approve, and the date of such action. If the vote was taken other than at a regularly scheduled meeting of the governing body describe the procedure.

The Recommendation was approved by the officers and Council of the Administrative Law and Regulatory Practice Section by electronic vote on November 17, 2010.

3. If this or a similar recommendation has been submitted previously to the House of Delegates or the Board of Governors, please include all relevant information, when and before what group the recommendation was considered and what action or position was taken on the matter.

Neither this nor any similar recommendation has been submitted previously to the House of Delegates or the Board of Governors.

4. Are there any existing Association policies which are relevant to this recommendation, and if so, how would they be affected by the adoption of this recommendation?

There are no existing Association policies that are directly relevant to this recommendation.

5. Explain what urgency exists which requires that action on this matter be taken at this meeting. If deferral is acceptable, note the time by which action is necessary.

The SEC is currently under a statutorily imposed deadline, pursuant to section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act²² (Dodd-Frank), to implement

the requirements of the new subsection 13(p) of the Exchange Act no later than 270 days after the date of enactment (i.e., July 21, 2010). Timely identification of this issue for the new Congress will provide an immediate opportunity to correct this significant flaw in legislative language before that deadline.

6. If the recommendation is a legislative resolve, indicate the current status in the Congress.

Not applicable.

7. If adoption of the recommendation would result in expenditures, estimate the funds necessary, suggest the anticipated source for funding, and list proposed direct and indirect costs. Indirect costs include those such as staff time or administrative overhead.

Not applicable.

8. Review the background of the proponents of the recommendation to determine if there are potential conflicts of interest. If such potential is found, list by name those proponents who have a material interest in the subject matter of the recommendation because of specific employment or representation of clients. Note all individuals who abstained from discussing or voting on the recommendation due to a conflict of interest.

There are no potential conflicts of interest by the proponents of the recommendation.

9. List the sections, committees, bar associations, or affiliated entities to which the recommendation has been referred, the date of the referral, and the response of each group, if known.

The recommendation was referred to the Sections of Business Law, Criminal Justice, and International Law on November 17, 2010. None of those Sections has had an opportunity to respond yet.

10. Indicate the name, address, and telephone number of the person who should be contacted prior to the meeting concerning questions about the report.

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²² Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

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11. Indicate the name of the person who will present the report to the House and who should be contacted at the meeting when questions arise concerning its presentation and debate. Please be sure to include email addresses and cell phone numbers for your on-site contacts.

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EXECUTIVE SUMMARY

1) Summary of the Recommendation

The recommendation urges Congress to amend subsection 13(p) of the Securities Exchange Act of 1934 (15 U.S.C. § 78m(p)) to define a person subject to the requirements of that subsection as “an issuer with securities registered under section 12 of the Exchange Act”.

2) Summary of the issue which the Recommendation addresses:

The current definition of “person” in subsection 13(p) of the Exchange Act is circular and vague. It therefore fails to give the Securities and Exchange Commission (SEC), the Department of State, and private-sector entities any meaningful guidance about the intended scope of coverage of its requirements.

3) An explanation of how the proposed policy position will address the issue:

It will recommend the specific adoption of language -- “an issuer with securities registered under section 12 of the Exchange Act” -- that is widely used and understood in securities regulation. The recommended change would provide a clearer delegation of authority to the SEC in implementing subsection 13(p)’s requirements, and make it substantially easier for both the SEC, in carrying out its regulatory responsibilities under subsection 13(p), and manufacturing entities, in seeking to comply with subsection 13(p), to determine whether that subsection’s requirements pertain to specific business entities.

4) A summary of any minority views or opposition which have been identified:

None that the Section is aware of.