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SEC ADOPTS DISCLOSURE RULES REGARDING CONFLICT MINERALS AND PAYMENTS TO GOVERNMENTS BY RESOURCE EXTRACTION ISSUERS

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Last month, the SEC issued final rules concerning disclosure of (1) the use of conflict minerals[1] and (2) payments made by resource extraction issuers to a foreign government or the U.S. federal government for the purpose of commercially developing oil, natural gas or minerals,[2] as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Under the new rules, a new Form SD ("Specialized Disclosure") will be used for issuers to report the use of conflict minerals and payments by resource extraction issuers to governments.

Conflict Minerals Disclosure Obligations

The SEC's final rules require an issuer to submit a report on the newly adopted Form SD if it uses "conflict minerals" that originated in the Democratic Republic of the Congo (the "DRC") or an adjoining country[3] (the "Covered Countries") in the manufacture of its products. The controversial rulemaking is in response to concerns that the exploitation and trade of conflict minerals by armed groups is helping to finance conflict in the DRC region and contributing to an emergency humanitarian crisis. Conflict minerals include tantalum, tin, gold, tungsten and derivatives of the foregoing minerals. A wide range of products may contain these minerals, such as:

- Jewelry
- Industrial processes like leather tanning
- Garment Accessories
- Aerospace Equipment
- Ammunition
- Carbide Tools
- Dental Materials
- Metal Alloys
- Electronic Circuits and Equipment
- Golf Clubs
- Light Bulb/X-Ray Filaments
- Jet Engine Components

[1] Conflict Minerals, Release No. 34-67716 (August 23, 2012), available at http://sec.gov/rules/final/2012/34-67716.pdf. The SEC initially proposed rules regarding conflict mineral disclosures in December 2010. See Conflict Minerals, Release No. 34-63547 (December 15, 2010), available at http://www.sec.gov/rules/proposed/2010/34-63547.pdf. Our client alert regarding the SEC's earlier proposal can be found at: http://www.wcsr.com/resources/pdfs/cs010511.pdf. The new requirements are set forth in new Section 13(p) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and related Rule 13p-1.

[2] Disclosure of Payments by Resource Extraction Issuers, Release No. 34-67717 (August 23, 2012), available at http://www.sec.gov/rules/final/2012/34-67717.pdf. The SEC initially proposed rules regarding payments by resource extractors to the Federal and foreign governments in December 2010. See Payments By Resource Extraction Issuers, Release No. 34-63549, available at http://www.sec.gov/rules/proposed/2010/34-63549.pdf. The new requirements are set forth in new Section 13(q) of the Exchange Act and related Rule 13q-1.

[3] Adjoining countries currently include Angola, Burundi, Central African Republic, the Republic of the Congo, Rwanda, South Sudan, Tanzania, Uganda and Zambia.

- Metal Wires
- PVC Manufacturing
- Electrodes
- Credit Cards

Unlike the proposed rules where disclosures would have occurred in an issuer's Form 10-K, the final rules provide for disclosure on the newly created Form SD. The Form SD will be deemed to be filed, as opposed to furnished (and thus potentially subject to securities liabilities); however, there will not be any separate CEO/CFO certifications related to this filing. In its adopting release, the SEC sets forth three steps for determining whether disclosure will be required and the content of any such required disclosure. Issuers should reevaluate the following steps annually following the rule's effective date to determine what, if any, reporting is required.

Step One: Determination of Covered Issuers

Issuers required to file reports under Section 13(a) or 15(d) of the Exchange Act are subject to conflict mineral reporting if conflict minerals are "necessary to the functionality or production" of their product, regardless of whether they manufacture the product directly or contract for its manufacture. The SEC does not provide a bright line test for determining whether a conflict mineral is used in the manufacture of a product or whether an issuer is deemed to contract for the manufacture of such a product; however, in the adopting release, the SEC provides guidance regarding the facts and circumstances analysis an issuer should undertake in making this determination. A safe harbor is provided from the rule for any issuer that does no more than (1) negotiate general terms with a manufacturer that do not directly relate to the manufacture of products containing conflict minerals, (2) affix its label or other mark to a product containing conflict minerals that was independently manufactured by a third party or (3) service, maintain or repair a product containing conflict minerals that was manufactured by an unrelated third party. If an issuer does not use conflict minerals in the production of its products, it is not required to take any action and does not need to file a Form SD. If an issuer determines it uses conflict minerals, it should proceed to the analysis outlined in Step Two.

Step Two: Determination of the Origins of Conflict Minerals and Related Disclosures

If conflict minerals are used in the manufacture of an issuer's products, the issuer must conduct a reasonable "country of origin" inquiry and make its report publicly available on its website. No specific due diligence procedures are outlined, but diligence should be conducted in good faith. If the issuer determines that the conflict minerals were sourced from, or may have been sourced from, one or more of the Covered Countries and were not from recycled or scrap sources, it should proceed to the analysis outlined in Step Three. If the issuer reasonably believes that the conflict minerals were sourced from scrap or recycled resources based on its due diligence efforts, it must file a Form SD with the SEC that discloses this determination and the nature of its diligence efforts. Issuers should note that special rules apply to minerals that come from recycled or scrap sources.

Step Three: Conflict Minerals Reporting and Supply Chain Diligence

If an issuer determines its products contain conflict minerals based on the steps outlined above, it must file a Form SD with the SEC that attaches a Conflict Minerals Report as an exhibit. The Form SD must include a certified independent private sector audit. If available, the issuer must use a nationally or internationally recognized due diligence framework for the conflict mineral in question. If the issuer determines that its products are not "DRC conflict free," its report must also include a description of the products manufactured or contracted to be manufactured, the facilities used to process the conflict minerals, the country of origin of the conflict minerals and the issuer's efforts to determine the identity of the mine or origin of the conflict minerals.

Issuers must begin to assess whether they are "DRC conflict free" or subject to the reporting required for the calendar year beginning January 1, 2013, with the first reports due May 31, 2014 and annual reports due each May 31 thereafter. The SEC estimates that the initial cost of compliance will be between $3 billion and $4 billion and the ongoing annual compliance cost will be between $207 million and $609 million. Note that Form SD reports will be filed annually on a calendar year basis regardless of the issuer's fiscal year. Companies unable to determine after reasonable inquiry whether the conflict minerals they use financed or benefited armed groups in the Covered Countries or whether such minerals were sourced from the Covered Countries may describe their products as "DRC conflict undeterminable" and will be subject to relaxed reporting requirements (e.g., no independent private sector audit will be required) for calendar years 2013 and 2014 (and two additional calendar years for smaller reporting companies). These issuers must still file a conflict minerals report, however.

New Disclosures Concerning Government Payments Made by Resource Extraction Issuers

Under the SEC's final rules regarding resource extraction, resource extraction companies required to file annual reports with the SEC (regardless of issuer size) must file a Form SD with the SEC to annually report information describing any payments made by the issuer or an affiliate to a foreign government or the U.S. federal government relating to the commercial development of oil, natural gas or minerals. Section 13(q) of the Exchange Act and the new SEC's newly promulgated Rule 13q-1 broadly define "commercial development" to include exploration, extraction, processing, export and other significant related actions, including the acquisition of a license for any such activities. "Payment" also covers a broad range of compensation and is deemed to include taxes, royalties, fees (including license fees), production entitlements, bonuses, dividends, payments for infrastructure improvements and other material benefits.

Payments reported on the Form SD must be broken out by amount, project, government and purpose; however, payments (or a series of related payments) equaling less than $100,000 in a fiscal year are considered de minimis and are not required to be reported. All information must be provided in an interactive data format.

The rules take effect for fiscal years ending after September 30, 2013. The first report filed may detail payments made between October 1, 2013 and the end of the issuer's fiscal year; but all subsequent fiscal year reports must contain full year data.

Action Items; Contact

Companies that manufacture or contract for the manufacture of products should assess whether any of their products may contain a conflict mineral, remembering that even a trace amount of a conflict mineral in the product will require disclosure under the SEC's rules. If a company determines its products may contain conflict minerals, the Company should begin preparing for the diligence it will conduct to determine whether these minerals are sourced from one of the Covered Countries as the diligence steps and related disclosures may be lengthy and complicated.

Resource extraction issuers should use this time before the rules take effect to set up a method for logging payments to the U.S. federal government and foreign governments. This should help ensure that these issuers are prepared to file the annual report required on Form SD beginning for fiscal years ending after September 30, 2013 as there is no transitional period once the rules take effect.

If you have any questions regarding the SEC's final rules, please contact Janet Lowder (http://www.wcsr.com/lawyers/janet-d-lowder), the principal drafter of this client alert, or you may contact the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link: http://www.wcsr.com/profSearch?team=corporateandsecurities.

A supplemental power point presentation to our alert, which includes the SEC's "flow chart" to assess whether conflict mineral disclosures are required, may be accessed here.