SUTHERLAND

LEGAL ALERT

July 2, 2012

SEC Announces Date to Consider Conflict Minerals Rule Adoption

On July 2, 2012, the U.S. Securities and Exchange Commission (SEC) announced that it will hold an open meeting on August 22, 2012, at 10 a.m., at its headquarters in Washington, D.C., to consider adopting rules that would regulate the use of so-called "conflict minerals." The minerals that will be regulated are: cassiterite, columbite-tantalite, gold, wolframite and their derivatives (the Conflict Minerals). We have included a copy of the SEC announcement.

If adopted, the rules will impact thousands of companies and their suppliers throughout the world that use Conflict Minerals in their manufacturing processes. **Manufacturers of electronics, pharmaceuticals, heavy equipment, clothing, jewelry and certain food items are likely to be affected**. **Companies that invest in these sectors may also be impacted.**

Below is a summary of the rules the SEC will consider on August 22.

Proposed SEC Requirements

The five SEC Commissioners will consider whether to adopt rules that would require U.S. issuers as well as certain foreign issuers to comply with new SEC reporting and disclosure requirements. As proposed, the rules would directly impact all issuers of securities subject to the reporting requirements of the Securities Exchange Act of 1934, if the issuer uses a Conflict Mineral originating in the Democratic Republic of the Congo or an adjoining country[1] (a DRC Country) in its manufacturing processes. As proposed, the rules would apply to an issuer regardless of whether it manufactures a product containing Conflict Minerals itself, or contracts with a third party that manufactures the product. The SEC has estimated that thousands of issuers will be impacted.

Under the proposed rules, issuers that use Conflict Minerals would be required to take the following actions:

- **Adopt** due diligence processes to determine the country of origin of the minerals they use.
- **Review** the chain of custody of the mineral from the country of origin up the supply chain to the issuer.
- **Disclose** in the issuer's annual report submitted to the SEC whether the Conflict Minerals the issuer uses did or did not originate in a DRC Country. If the issuer's minerals did not originate in a DRC Country, the issuer would also disclose that fact on its public website.
- **Submit** a "Conflict Minerals Report" to the SEC and make the report publicly available on the issuer's website, if the issuer determines that the Conflict Minerals it uses originated in a DRC Country, or if the issuer cannot rule out that possibility. The Conflict Minerals Report would have to describe the issuer's products that are not "DRC conflict free," i.e., products that contain or could

[1] It is expected that the adjoining countries will be identified as Angola, Burundi, Central African Republic, Rwanda, Southern Sudan, Tanzania, Uganda and Zambia.

contain conflict minerals that "directly or indirectly finance or benefit armed groups in the DRC or an adjoining country."[2]

- **Hire** an independent auditor to audit the issuer's country of origin and chain of custody due diligence process, if the issuer is required to submit a Conflict Minerals Report.

Why the Rules Are Being Considered for Adoption Now

The rules would put into place a regulatory framework for enforcing section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Section 1502 identifies four minerals – gold, columbite-tantalite (tantalum), cassiterite (tin) and wolframite (tungsten), and their derivatives, as "conflict minerals," due to the possibility that the mining of these minerals may finance violent levels of conflict in the DRC. In an effort to prevent violence in the DRC and surrounding countries, Congress ordered the SEC to adopt rules that regulate the use of Conflict Minerals in the manufacturing processes of companies selling shares in the U.S.

The SEC first proposed rules for Conflict Minerals in December 2010. Since that time, it has been under increasing pressure from businesses, the U.S. Congress and certain non-governmental organizations to amend, reject or adopt Conflict Minerals rules. Congress held hearings on the issues on May 10, 2012.

Based on comments it has received on the proposed rules, **the following topics, among others, are expected to be discussed at the August 22 meeting**:

- The definition of key terms, such as "manufacture" and "contracts to manufacture."
- Whether issuers will be provided with specific SEC permission to rely on reasonable representations of processing facilities and others in the supply chain.
- Phase in of disclosure requirements, i.e., how soon will issuers be required to comply with the regulations.
- Provision by the SEC of examples of applicable due diligence standards.
- The cost of compliance.
- Whether it may be impossible for a downstream company to verify that the minerals it receives are conflict free, apart from not purchasing minerals from a DRC Country altogether.
- Whether the regulations may have a negative impact on the global competitiveness of issuers subject to the regulations.

[2] *See* SEC Proposing Release No. 34-63547; File No. S7-40-10 (December 15, 2010).

What We Anticipate: The Need to Adopt Issuer Policies and Supply Chain Risk Management Systems

Based on the SEC's proposed rules, it is likely that issuers will need to develop special risk management programs if they use any of the Conflict Minerals in their manufacturing processes. Out of necessity, these risk management systems will need to depend on the issuer's suppliers, and the suppliers, in turn, will be tasked with adapting to the internal policies and procedures adopted by the issuer. On proposing the rules in December 2010, the SEC stated that issuers may be able to rely on "reasonably reliable" representations from smelters and suppliers, with the assumption that each smelter and supplier will comply with recognized national or international standards to verify the country of origin and determine whether the minerals used by the issuer have been mined, transported and handled in a manner that does not finance armed conflict in a DRC Country.[3] We would expect the SEC to make this point clear in the August 22 meeting.

Based on the rules, as proposed, it is expected that issuers and their suppliers will be tasked with:

- Developing internal policies for their supply chains for Conflict Minerals
- Communicating those policies to interested persons, e.g., suppliers and public shareholders
- Identifying management who will be responsible for implementing internal policies
- Identifying risks in the supply chain
- Engaging independent auditors
- Developing recordkeeping systems to archive due diligence processes
- Developing appropriate disclosure for the SEC, in compliance with SEC rules.

Sutherland will continue to follow and report on developments on this issue. If you would like to discuss the proposed rules or their possible impact on your company, please contact any of the persons listed below.

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If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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[3] A frequently cited international standard for supply chain due diligence for tin, tantalum, tungsten and gold is the OECD's "Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas." Sutherland would be happy to provide you with a copy of the OECD's guidance.

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