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SEC Adopts Final Rules Regarding Conflict Minerals Disclosure

On August 22, 2012, the Securities and Exchange Commission adopted a final rule implementing disclosure and reporting requirements regarding the use by issuers of conflict minerals from the Democratic Republic of the Congo (DRC) and adjoining countries (collectively, the "Covered Countries"). Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") added Section 13(p) to the Securities Exchange Act of 1934 (the "Exchange Act"), which required the SEC to issue rules regarding conflict minerals disclosure. Issuers whose products do not contain any conflict minerals are not subject to these new disclosures.

"Conflict minerals" are defined to include gold, cassiterite (the metal ore used to produce tin), columbite-tantalite (the metal ore from which tantalum is extracted) and wolframite (the metal ore used to produce tungsten), their derivatives, or any other minerals or their derivatives determined by the US Secretary of State to be financing conflict in the Covered Countries. In addition to the DRC, Angola, Burundi, the Central African Republic, the Republic of the Congo, Rwanda, South Sudan, Tanzania, Uganda and Zambia are currently included as Covered Countries.

Click here to view the adopting release for the rule (Release No. 34-67716).

Disclosure Deadline for New Form SD

Conflict minerals disclosures will be filed on new Form SD (specialized disclosure report) under the Exchange Act, rather than in an issuer's Annual Report on Form 10-K as was initially proposed. The first necessary disclosures (if any) will be made on a Form SD filed no later than May 31, 2014, covering the 2013 calendar year. Issuers will report on Form SD on a calendar year basis, regardless of the issuer's fiscal year end. The instructions to Form SD contain the key provisions and important definitions that guide the conflict minerals disclosure to be provided by issuers. If Form SD includes disclosure regarding payments made in connection with resource extraction, as mandated by the SEC's recent rules adopted pursuant to Section 1504 of the Dodd-Frank Act, such payment data would be required to be tagged using an XBRL taxonomy currently being developed by the SEC specifically for Form SD.

Step One—Determining Whether or Not the Rule Applies

The rule applies to issuers who file reports with the SEC under Sections 13(a) or 15(d) of the Exchange Act and for which conflict minerals are "necessary to the functionality or production of a product to be manufactured by the company" or "contracted to be manufactured." If an issuer determines it does not utilize conflict minerals or their derivatives in any production or manufacturing process (which includes components

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used in assembling a product as well as products manufactured for the issuer under contract), the rule would not require the issuer to take any action or make any disclosures with respect to conflict minerals. The rule applies to domestic companies, foreign private issuers and smaller reporting companies.

The rule does not define the phrases "contract to manufacture," "necessary to the functionality" of a product or "necessary to the production" of a product, but the SEC did provide some additional guidance for issuers to consider in determining whether or not those phrases are applicable. For example, with respect to the phrase "contract to manufacture," the determination of whether or not an issuer will be considered to be "contracting to manufacture" a product will be based on a facts and circumstances test that examines the degree of actual influence and amount of control that such issuer has over the manufacturing of the product in question, and the rule release provides a safe harbor to any issuer who does no more than:

- negotiate general terms with a manufacturer that do not pertain directly to the manufacturing of the products containing conflict minerals;
- affix its own marks or trade dress to independently manufactured products containing conflict minerals; or
- service, maintain or repair a product containing conflict minerals that was manufactured by a third party.

The rule also clarifies that issuers who are engaged in the mining of conflict minerals will not be covered by the rule unless they also manufacture or contract to manufacture products containing conflict minerals.

Regarding the determination of whether or not conflict minerals are "necessary to the functionality" of a product, the SEC provided the following factors to consider:

- Is the conflict mineral not a naturally occurring byproduct of the manufacturing process, but rather contained in the final product because it was intentionally added?
- Is the conflict mineral necessary to the product's generally expected use, function or purpose?
- Is the conflict mineral included for ornamentation, decoration or embellishment, and, if so, is the primary purpose of the product ornamentation or decoration?

While at least some amount of conflict minerals must actually be contained in the final product in order for the conflict minerals to be "necessary to the functionality" or "necessary to the production" of such product, there is no "de minimis" quantity exception contained in the rule or Form SD.

The rule excludes conflict minerals that are "outside the supply chain" before January 31, 2013. In order to qualify as "outside the supply chain," the conflict minerals in question must be (1) smelted (in the case of columbite-tantalite, cassiterite and wolframite); (2) fully refined (in the case of gold); or (3) not smelted or fully refined and located outside of the Covered Countries.

Step Two—Performing a Country of Origin Inquiry

If it is determined under Step One that the rule applies, the issuer will need to conduct a "reasonable country of origin inquiry" regarding the origin of the conflict minerals. If, after a reasonable country of origin inquiry that was performed in good faith and reasonably designed to determine if any of the issuer's conflict minerals either (1) originated in the Covered Countries or (2) are from scrap or recycled sources, the issuer either (A) knows that its conflict minerals did not originate in the Covered Countries or are from recycled or scrap sources, or (B) has no reason to believe that the conflict minerals may have originated in the Covered Countries or may not be from scrap or recycled sources, then the issuer must disclose on Form SD the determination and describe both the process and results of the reasonable country of origin inquiry it used in reaching this determination. The issuer would also be required to make this disclosure available on its website for a one-year period, disclose in its Form SD the Internet address where this disclosure is posted, and maintain records demonstrating that its conflict minerals did not originate in the Covered Countries.

Although the rule does not include requirements for a reasonable country of origin inquiry, the release provides some details for how those inquiries should be conducted. First, if the issuer receives representations from its processing facilities or intermediate suppliers that its conflict minerals did not originate in the Covered Countries or were from recycled or scrap sources, that would

be sufficient to satisfy the inquiry unless the issuer has reason to believe that such representations are untrue. Alternatively, the inquiry would be satisfied if the processing facility providing the issuer the conflict minerals was awarded a "conflict-free" designation by a recognized industry group that requires an independent private sector audit of such facility, or if the processing facility that is not part of a recognized industry group otherwise obtains a publicly available independent private sector audit.

Subject to the country of origin inquiry satisfying the "good faith" and "reasonably designed" requirements described above, an issuer does not need to obtain representations or confirmations from every single supplier of conflict minerals in order to conclude that its products are "DRC conflict free." As stated in the release, "if reasonable inquiry has been made, and if no evidence of [Covered Country] origin has arisen, and if the origin of only a small amount of gold were still unknown, a manufacturer should be allowed to declare that its gold is not from the [Covered Countries] and is DRC conflict free."

Step Three—Due Diligence Inquiry and Conflict Minerals Report

Likewise, if the issuer either (1) knows or has reason to believe that its conflict minerals may have originated in the Covered Countries, or (2) knows or has reason to believe that its conflict minerals may not actually be from recycled or scrap sources, then the issuer must perform a due diligence inquiry on the source and chain of custody of its conflict minerals and file a Conflict Minerals Report (as described below) as an exhibit to its Form SD. The due diligence inquiry performed regarding the conflict minerals must conform to a nationally or internationally recognized due diligence framework.

If the issuer, through this due diligence inquiry, is able to determine that its conflict minerals in its products did not come from the Covered Countries or are from recycled or scrap sources, the issuer would no longer be required to file a Conflict Minerals Report with respect to such products. However, in such a case, the issuer would still be required to include information on its Form SD regarding the country of origin and due diligence inquiries that it undertook, in order to demonstrate the basis for its belief that the conflict minerals in question did not originate in the Covered Countries or came from recycled or scrap sources.

The Conflict Minerals Report is required to contain different information depending on the results of the diligence inquiry and must be posted on the issuer's website. If, after the due diligence inquiry, the issuer is able to determine that the minerals in its products did not finance or benefit armed groups, it can classify its products as "DRC conflict free." Such an issuer must obtain a private sector audit of its Conflict Minerals Report from an independent auditing firm, and in its Conflict Minerals Report must:

- certify that it obtained such audit;
- identify the auditor; and
- include the audit report of such auditor.

If an issuer determines that its products are not "DRC conflict free," then such issuer must also include in its Conflict Minerals Report (in addition to the audit requirements described above):

- a list of the products either manufactured or contracted to be manufactured by such issuer that have been determined not to be "DRC conflict free";
- information regarding the facilities used to process the conflict minerals contained in such listed products;
- the country of origin of the conflict minerals contained in such listed products; and
- a description of what efforts were undertaken by the issuer to determine the mine or location of origin of its conflict minerals with the greatest possible specificity.

Pursuant to the release, unless the Government Accountability Office provides new standards to govern the independent private sector audit mentioned above, such audit must be performed in accordance with Generally Accepted Government Auditing Standards. In the release, the SEC also discussed the independence requirement pertaining to the audit, and stated that it would not be inconsistent with the independence requirements of Regulation S-X if the issuer's independent public accountant also performed the audit of the Conflict Minerals Report. However, the independent private sector audit of the Conflict Minerals Report would be considered a "non-audit service," meaning that fees related to the audit would need to be reported in the "All Other Fees" category of accountant fee disclosure, and that the engagement of the independent public

accountant to perform the private sector audit would be subject to the audit committee pre-approval requirements of Rule 2-01(c)(7) of Regulation S-X. The rule also clarifies that the objective of the audit report is "to express an opinion or conclusion as to whether the design of the [issuer's] due diligence measures as set forth in, and with respect to the period covered by, the [issuer's] Conflict Minerals Report, is in conformity with, in all material respects, the criteria set forth in the nationally or internationally recognized due diligence framework used by the [issuer], and whether the [issuer's] description of the due diligence measures it performed as set forth in the Conflict Minerals Report, with respect to the period covered by the Report, is consistent with the due diligence process that the [issuer] undertook."

"DRC Conflict Undeterminable" and Smaller Reporting Companies

The rule also added an additional temporary classification, "DRC conflict undeterminable." For a two-year period beginning after the initial implementation of the rule, if an issuer is unable to determine whether or not the conflict minerals in its products originated in the Covered Countries or benefited armed groups in the Covered Countries, it can classify such products as "DRC conflict undeterminable." This period is extended to four years for smaller reporting companies, which is the sole relief for disclosure obligations of smaller reporting companies with respect to conflict minerals. As a result of this classification, the issuer must provide the following information in its Conflict Minerals Report:

- a list of the products that it has classified as "DRC conflict undeterminable";
- information regarding the facilities used to process the conflict minerals contained in such products;
- the country of origin of the conflict minerals contained in such products, if known;
- a description of what efforts were undertaken by the issuer to determine the mine or location of origin of its conflict minerals with the greatest possible specificity; and
- a description of the steps it has taken or will take, if any, to improve its due diligence process and mitigate the risk that its necessary conflict minerals may benefit armed groups.

No private sector audit is required for a Conflict Minerals Report that deals solely with products classified as "DRC conflict undeterminable."

Recycled and Scrap Sources of Conflict Minerals

The rule also provided specific requirements regarding the Conflict Minerals Report and the necessary due diligence inquiry with respect to conflict minerals derived from recycled or scrap sources. As mentioned above, if an issuer is unable to reasonably conclude that its conflict minerals came from recycled or scrap sources, it is required to perform a due diligence inquiry on the source and chain of custody of its conflict minerals and file a Conflict Minerals Report as an exhibit to its Form SD. If the conflict mineral in question is gold, the only conflict mineral for which there is a nationally or internationally recognized framework for making the determination as to whether or not a conflict mineral came from recycled or scrap sources, the due diligence inquiry is required to be performed in accordance with the Organisation for Economic Co-operation and Development's Due Diligence Guidance, and the Conflict Minerals Report of the issuer in question must be audited. For any other conflict mineral, an issuer must provide a description of its due diligence inquiry in its Conflict Minerals Report, but it will not be required to obtain an audit of such report.

Practical Considerations

Issuers required to make disclosures regarding conflict minerals will not need to file their initial Form SD, which will include disclosures regarding calendar year 2013, until May 31, 2014. Although this timing does provide issuers with some time to prepare, due to the complex nature of the rule and the highly specific fact-based inquiries that must be made, issuers should consider familiarizing themselves with the contents of Form SD well in advance of the first reporting period, and should consider now the steps they should take to ensure their compliance with the rule and evaluate their disclosure processes regarding conflict minerals.

Issuers who have determined that they use conflict minerals should consider establishing a multidisciplinary team composed of personnel involved with manufacturing, purchasing, financial reporting and legal compliance, which will be charged with conflict minerals compliance (a "Conflict Minerals Compliance Team"). The Conflict Minerals Compliance Team would be responsible for designing and performing the necessary inquiries, gathering the necessary documentation, and preparing the Form SD and Conflict Minerals Report (if necessary). Because the necessary inquiries are fact-specific and particular to each issuer, the Conflict Minerals Compliance Team should include individuals who are intimately familiar with the issuer's manufacturing process and supply chain. The Form SD may be signed by any executive officer of the issuer, so it may make sense for an executive officer who is knowledgeable regarding the issuer's manufacturing process and supply chain (e.g., the vice president of manufacturing) to lead the Conflict Minerals Compliance Team and take responsibility for executing the Form SD.

If an independent audit may be required, the Conflict Minerals Compliance Team (with oversight of the Board Audit Committee of an issuer) should also assist with the selection of an independent auditor and coordinate with the independent auditor to perform the audit. Regardless of whether or not an issuer chooses to form a Conflict Minerals Compliance Team, issuers should consider initiating a dialogue with their current and alternative suppliers of conflict minerals covered by the rule, and discuss what steps will be taken by those suppliers to document the sources of those conflict minerals. As the rule permits issuers to rely on representations and confirmations from suppliers regarding conflict minerals, issuers may be able to reduce their compliance costs by reliance on such representations from their suppliers.