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Client Alert

Global Regulatory Enforcement

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The SEC's New Rules on Conflict Minerals

The Securities and Exchange Commission ("SEC") adopted new reporting rules last month pertaining to conflict minerals as required by section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The aim of Congress in mandating new SEC disclosure requirements is to increase public awareness and, ultimately to inhibit the ability of armed groups in the Democratic Republic of Congo ("DRC") and certain "Covered Countries" (Angola, Burundi, Central African Republic, Rwanda, South Sudan, Tanzania, Uganda and Zambia) from funding their war efforts through exploitation of the conflict mineral trade. Conflict minerals, which are prevalent in the supply chains of electronics manufacturers, include tin, tantalum, tungsten, and gold.[1]

The new rules require publicly traded retail and manufacturing companies to evaluate and report on the use of conflict minerals in their supply chain, and provide public disclosure regarding their investigation and findings. For affected companies, the conflict minerals disclosures are initially due no later than May 31, 2014, covering the 2013 calendar year. Yet the rule exempts conflict minerals that are "outside the supply chain" (i.e., already smelted or fully refined, or outside the DRC or adjoining countries) prior to January 31, 2013; therefore, a company may not need to evaluate existing products already in inventory prior to January 31, 2013.

Technically, the SEC's conflict minerals rules apply only to publicly traded companies. However, they will also impact private companies supplying public companies with products that potentially contain conflict minerals. Pursuant to the rules, such private companies must be prepared to participate in a public company's mandated due diligence and vetting efforts.

Under the SEC's conflict minerals rules, a public company is subject to the following three-step process. The flowchart (as prepared by the SEC as part of its rulemaking) included at the end of this memorandum is a useful companion resource.

1. Determine Applicability The first step is to determine whether "conflict minerals are necessary to the functionality or production of [any] product manufactured by" or "contracted to be manufactured" by the company. If this standard is not met, the company is not required to take any action, make any disclosures, or submit any reports. If this standard is met, the company must proceed to the second step below.

The SEC did not define the terms "contract to manufacture" or "necessary to the functionality" in its final rule. In determining whether a conflict mineral is "necessary to the functionality" of a product, a company should consider (1) whether the conflict mineral is actually included in the product itself (i.e., not simply as a catalyst, in a tool, or in some other aspect of the production process), and (2) whether the conflict mineral is necessary to produce the product (i.e., it is necessary to the product's function, not simply ornamental).

Whether a company "contracts to manufacture" a given product will depend on the degree of influence the company exercises over the components to be included in a product containing conflict minerals. If a company simply (1) specifies or negotiates, with a manufacturer, contractual terms that do not relate to the manufacturing of the product itself, (2) affixes its brand, marks, logo, or label to a generic product manufactured by a third party, or (3) repairs, services, or maintains a product manufactured by a third party, then the company may not have "contracted to manufacture" a product.

2. Country of Origin Inquiry & Disclosure If a company determines that it is subject to the rule per the first step, it must "conduct a reasonable country of origin inquiry regarding the origin of its conflict minerals." This inquiry must be conducted in good faith and must be reasonably designed to determine whether any of its conflict minerals originated in the DRC or other "Covered Countries," or are from recycled or scrap sources. After this inquiry, if a company concludes that it has no reason to believe its conflict minerals originate in a DRC or an adjoining country, or reasonably believes they come from recycled or scrap sources, it must provide public disclosures regarding its investigation and findings as part of "Specialized Disclosure" in a new "Form SD." The description of findings also must appear on the company's Internet website. If, however, a company determines its conflict minerals did originate or *may have* originated in the DRC or adjoining countries, and not from recycled or scrap sources, it must proceed to the third step below (in addition to providing a Form SD).

3. Due Diligence & Conflict Minerals Report Under the third step, if applicable, the company must exercise due diligence on the source and chain of custody of its conflict minerals and file a "Conflict Minerals Report" outlining its due diligence measures, describing the products containing conflict minerals, and providing a determination as to whether its products are "DRC Conflict Free." Generally,

a product qualifies as DRC Conflict Free if its conflict minerals originate (or may originate) from the DRC or adjoining countries, but (1) do not finance or benefit armed groups, or (2) are derived from recycled or scrap sources.

SEC rules require the use of a nationally or internationally recognized due diligence framework, such as that approved by the Organization for Economic Co-operation and Development ("OECD"). The SEC rules also require the use of an independent, private sector auditor to review the Conflict Minerals Report to opine on the quality and design of the due diligence measures reflected in the Conflict Minerals Report.

If its conflict minerals are deemed DRC Conflict Free, a company must undertake the following audit and certification requirements: (1) obtain an independent private sector audit of its Conflict Minerals Report; (2) certify that it obtained such an audit; and (3) include the audit report as part of the Conflict Minerals Report. If, however, a company determines that its conflict minerals are not DRC Conflict Free, the company, in addition to the audit and certification requirements, would be required to describe with the greatest possible specificity in its Conflict Minerals Report: (1) the products manufactured or contracted to be manufactured that have not been found to be DRC Conflict Free; (2) the facilities used to process the conflict minerals in those products; (3) the country of origin of the conflict minerals in those products; and (4) the efforts to determine the mine or location of origin.

Gold is currently the only mineral with a nationally or internationally recognized due diligence framework for determining whether it is recycled or scrap. The framework is part of the OECD Due Diligence Guidance. Accordingly, with regard to gold, if a company cannot reasonably conclude after its inquiry that any gold used in its products is from recycled or scrap sources, then the company is required to undertake due diligence such as in accordance with the OECD Due Diligence Guidance, and obtain an audit of the Conflict Minerals Report. With regard to the other conflict minerals (tin, tantalum, and tungsten), a different procedure applies until a recognized due diligence framework is developed. If the company cannot reasonably attribute its conflict tin, tantalum, or tungsten from Covered Countries to recycled or scrap sources, the company is required to describe the due diligence measures it exercised in its Conflict Minerals Report, and no independent private sector audit is required.

The OECD guidance, including the due diligence supplement for gold, is available here.

Although the conflict minerals rules are effective for calendar year 2013, there is a "transition period" of two years during which a company is permitted to describe its products as DRC Conflict Undeterminable. A company may rely upon a DRC

Conflict Undeterminable description if due diligence efforts were not conclusive as to a conflict mineral's country of origin, its DRC Conflict Free status, or whether it came from recycled or scrap sources. During this transition period, findings of DRC Conflict Undeterminable need not be reviewed by an independent private sector auditor.

Click here to view the flowchart of the final rule.

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1. The term "conflict mineral" is defined in section 1502(e)(4) of the Act as (A) columbite-tantalite, also known as coltan (the metal ore from which tantalum is extracted); cassiterite (the metal ore from which tin is extracted); gold; wolframite (the metal ore from which tungsten is extracted); or their derivatives; or (B) any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country.