INSIGHTS

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SECURITIES DISCLOSURE

SEC Adopts Final Conflict Minerals Disclosure Rule

The SEC's new conflict minerals rule imposes a three-step process for companies to follow to determine whether, and if so, how, they must make disclosures about any conflict minerals contained in products they manufacture or contract to manufacture. The first disclosures are not required to be made until May 2014, but significant advance preparation is required.

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On August 22, 2012, and as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the US Securities and Exchange Commission adopted the final rule regarding disclosure of the use of conflict minerals that originated in the Democratic Republic of the Congo (DRC) or an adjoining country.[1] The rule was originally proposed on December 15, 2010.[2]

The centerpiece of the final conflict minerals rule is Form SD, a new form created specifically for specialized disclosures. The text of the SEC's conflict minerals disclosure requirements is contained in Section 1 of Form SD. (Form SD also is being used for the purpose of the new resource extraction payment disclosures.[3])

Determining whether, and to what extent, a company is required to make conflict minerals disclosure involves a three-step process. The first step involves an analysis of whether a company is subject to the rule. If so, the second step is to conduct a reasonable country of origin inquiry to determine whether the conflict minerals originated in the DRC or an adjoining country. Depending upon the outcome of that inquiry, the company may be required to proceed to the third step, which involves supply chain due diligence and may require the preparation of a Conflict Minerals Report.

Conflict Minerals

"Conflict minerals" are specifically defined in the rule to include:

- Columbite-tantalite (coltan);
- Cassiterite;
- Gold; and
- Wolframite.

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Derivatives of the foregoing, limited to tantalum, tin, and tungsten, also fall within the definition of conflict minerals. The Secretary of State may expand the conflict minerals definition by determining that additional minerals or derivatives are financing conflict in the DRC or an adjoining country.

The conflict minerals disclosure rule is applicable to companies in many industries because numerous types of products are made with conflict minerals. Tantalum, which is extracted from columbite-tantalite, is used in electronic components such as mobile telephones, computers, videogame consoles and digital cameras, and as an alloy for making carbide tools and jet engine components. Gold, in addition to jewelry, is used for electronic, communications and aerospace equipment. Tungsten, which is extracted from wolframite, is used for metal wires, electrodes and contacts in lighting, electronic, electrical, heating and welding applications. Cassiterite is the metal ore from which tin is extracted.

Companies Subject to the Rule

According to Section 13(p) of the Securities Exchange Act of 1934 and new SEC Rule 13p-1, the conflict minerals disclosure rule applies to any company that files reports with the SEC under Section 13(a) or Section 15(d) of the Exchange Act if conflict minerals are necessary to the functionality or production of a product manufactured or contracted to be manufactured by that company. The disclosure requirements apply to foreign private issuers as well as to domestic issuers and to smaller reporting companies. There is no *de minimis* exception.

Even if a company, such as a private company, is not directly covered by the new rule, it may nevertheless be impacted by the conflict minerals disclosure rule to the extent that it is part of the supply chain of a public company that is subject to the rule.

Manufacture. The SEC did not define what is meant by the term "manufacture." However, Instruction 1 to Item 1.01 of Form SD specifies that a company that only mines conflict minerals would not be considered to be manufacturing those minerals.

Contracting to Manufacture. While the SEC did not define the term "contracting to manufacture," the adopting release provides guidance in this area. To be considered to be contracting to manufacture a product, a company must have some actual influence over the manufacturing of that product. This requires a facts and circumstances analysis that takes into account the degree of influence a company exercises over the materials, parts, ingredients or components of the product being manufactured. The SEC's guidance specifies that merely doing the following *does not* rise to the level of contracting to manufacture:

- Specifying or negotiating contractual terms with a manufacturer that do not directly relate to the manufacturing of the product (such as training or technical support, price, insurance, indemnity, intellectual property rights, dispute resolution, or other like terms or conditions concerning the product);

- Affixing a brand, marks, logo or label to a generic product manufactured by a third party; or

- Servicing, maintaining, or repairing a product manufactured by a third party.

The exception in the guidance for specifying or negotiating contractual terms does not apply if such terms are the practical equivalent of terms directly related to the manufacture. For example, specifying that a manufacturer should include a particular conflict mineral in a product would be viewed as contracting to manufacture under the rule, even though the company may not be exerting a substantial influence on the overall manufacturing process.

Necessary to the Functionality

To determine whether a conflict mineral is "necessary to the functionality" of a product, the SEC guidance stated that a company should consider:

- Whether the conflict mineral is intentionally added to the product, or any component of the product, and is not a naturally-occurring by-product;
- Whether the conflict mineral is necessary to the product's generally expected function, use or purpose; and
- If conflict minerals are incorporated for purposes of ornamentation, decoration, or embellishment, whether the primary purpose of the product is ornamentation or decoration.

Some products may have multiple generally expected functions, uses or purposes (*e.g.*, a smart phone). If a conflict mineral is necessary to any of those functions, the mineral will be considered necessary to the functionality of the product.

Necessary to the Production

To determine whether a conflict mineral is "necessary to the production" of a product, a company should consider:

- Whether the conflict mineral is intentionally included in the product's production process, other than being included in a tool, machine, or piece of equipment used to produce the product (such as computers or power lines);
- Whether the conflict mineral is included in the product; and
- Whether the conflict mineral is necessary to produce the product.

The SEC emphasized that for a conflict mineral to be considered necessary for the production of a product, it must be *contained* in the product. Therefore a conflict mineral that is used as a catalyst will not be considered necessary to the production of the product if it is not present in the product. However, if trace amounts appear because that catalyst is not completely washed away, the product will be viewed as containing a conflict mineral that is necessary to its production and will be subject to the conflict minerals disclosure rule.

The SEC's guidance also makes clear that to be necessary for the production, a conflict mineral must not only be contained in the product, it must be intentionally added. For example, if tin is present in a metal alloy only as a contaminant, and is not part of the specifications of the alloy, it is not intentionally added. Therefore, the SEC does not consider it to be necessary to the functionality or production of the product containing the alloy.

Prototypes and other demonstration devices and materials containing conflict minerals are not considered products for the purpose of the conflict minerals rule. However, once a company offers any such product for sale to third parties, they will be subject to the disclosure rule.

Reasonable Country of Origin Inquiry

A public company that is subject to the conflict minerals disclosure rule must conduct a reasonable country of origin inquiry. This must be a good faith inquiry that is reasonably designed to determine whether any of the conflict minerals it uses in manufacturing originated in the DRC or an adjoining country, or are from recycled or scrap sources.

The rule does not prescribe the steps for a reasonable country of origin inquiry. According to the adopting release, a company satisfies this requirements if it seeks and obtains reasonably reliable representations indicating the facility at

which its conflict minerals were processed and demonstrating that those conflict minerals did not originate in the DRC or an adjoining country, or that they came from recycled or scrap sources.

These representations may come directly from the processing facility or indirectly through the company's immediate supplier, but the company must have a reason to believe the representations are true, based on the surrounding facts and circumstances. The SEC has stated that it is reasonable to believe representations if a processing facility has received a "conflict-free" designation by a recognized industry group that requires an independent private sector audit of the smelter or from an individual processing facility that has obtained an independent private sector audit that is publicly available.

A company must take into account any warning signs that its conflict minerals may have originated in the DRC or an adjoining country, or did not come from recycled or scrap sources when evaluating the results from its country of origin inquiry. A representation that a conflict mineral originated in a country that has a limited supply of that mineral is an example of a possible warning sign.

The rule does not require a company to receive representations from all of its suppliers. If a company reasonably designs and performs an inquiry in good faith, it may conclude that its conflict minerals did not originate in the DRC or an adjoining country, even if it does not hear from all of its suppliers, as long as it does not ignore warning signs.

The reasonable country of origin inquiry standard can be satisfied even if it does not provide a definitive answer as to where the conflict minerals originated. According to the adopting release, a company may explicitly state in its disclosure (if true) that its reasonable country of origin inquiry was reasonably designed to determine whether the conflict minerals did originate in the DRC or an adjoining country, or did not come from recycled or scrap sources, and was performed in good faith, and that its conclusion that the conflict minerals did not originate in the DRC or an adjoining country, or came from recycled or scrap sources, was made at that reasonableness level.

The rule does not require companies to retain reviewable business records to support the reasonable country of origin conclusion that its conflict minerals did not originate in the DRC or an adjoining country. However, the adopting release notes that maintenance of appropriate records may be useful in demonstrating compliance with the rule. Also, the nationally or internationally recognized due diligence framework that a company applies may have record maintenance requirements.

Source and Chain of Custody Due Diligence

Form SD Only. If, based on a reasonable country of origin inquiry:

- The company *knows* that the minerals *did not* originate in the DRC or an adjoining country,
- The company *knows* that the minerals *are* from scrap or recycled sources *or*
- The company *has no reason to believe* that the minerals *may have* originated in the DRC or an adjoining country or *may not be* from scrap or recycled sources,

then the company would be required to file a report on Form SD, but would *not* be required to include a Conflicts Minerals Report as an exhibit to such filing. In this case, the Form SD would have to describe the results of its country of origin inquiry and how the company conducted such inquiry. The company would be required to make this description publicly available on its website, providing the Internet address of such disclosure in its Form SD.

Form SD Plus Source and Chain of Custody Due Diligence

If, on the other hand, based on its reasonable country of origin inquiry:

- The company *knows or has reason to believe* that any of its necessary conflict minerals *may have* originated in the DRC or an adjoining country *and*

- The company *knows or has reason to believe* that the minerals *may not* be from scrap or recycled sources,

then, the company will need to perform due diligence on the source and chain of custody of the conflict minerals that it uses. The due diligence measures employed must conform to a nationally or internationally recognized due diligence framework.

If, as a result of due diligence, the company determines that its conflict minerals *did not* come from the DRC or an adjoining country, or that they did come from recycled or scrap sources, the company will have to disclose its determination and describe both its reasonable country of origin inquiry and its due diligence efforts in its Form SD and on its website, but would not be required to prepare a Conflicts Minerals Report.

If, based on its due diligence, the company is unable to conclude that its conflict minerals *did not* come from the DRC or an adjoining country, or that they came from recycled or scrap sources, the company, in addition to providing the above-described Form SD disclosure, will need to prepare and file a Conflict Mineral Report as an exhibit to its Form SD.

Recognized Due Diligence Framework

The Organization for Economic Cooperation and Development (OECD) has developed a due diligence framework that the adopting release identified as the only nationally or internationally recognized due diligence framework currently available for conflict minerals source and chain of custody due diligence. With respect to recycled or scrap sources, the OECD has a supplement relating to gold.[4] According to the adopting release, no other conflict mineral has a nationally or internationally recognized due diligence framework for determining whether it is from recycled or scrap sources. Companies are nevertheless required to exercise due diligence with respect to cassiterite, columbite-tantalite or wolframite to determine that their conflict minerals were from recycled or scrap sources without the benefit of a due diligence framework until such time as one becomes available.

Conflict Minerals Report

A Conflict Minerals Report must describe the due diligence methods a company exercised with respect to source and chain of custody. Additional requirements of the Conflict Minerals Report will depend on whether the company's conflict minerals are determined to be "DRC conflict free."

A product will be considered "DRC conflict free" if it does not contain conflict minerals necessary to the functionality or production of that product that directly or indirectly finance or benefit armed groups in the DRC or an adjoining country. Conflict minerals that are derived from recycled or scrap sources, as opposed to mined sources, are also considered "DRC conflict free."

To be considered as coming from recycled or scrap sources, the conflict minerals must be from recycled metals that are reclaimed end-user or post-consumer products, or scrap processed metals created during product manufacturing. Recycled metal includes excess, obsolete, defective, and scrap metal materials that contain refined or processed metals that are appropriate to recycle in the production of tin, tantalum, tungsten, and/or gold. However, minerals that are partially

processed, unprocessed or a bi-product from another ore will not be included in the definition of recycled metal.

If, based on its source and chain of custody due diligence, a company determines that its conflict minerals are "DRC conflict free," it must:

- Describe its source and chain of custody due diligence measures;
- Obtain an independent private sector audit of its Conflict Minerals Report;
- Certify that it obtained such an audit;
- Include the audit report as part of the Conflict Minerals Report; and
- Identify the auditor.

If a company finds that its products are not "DRC conflict free," then, in addition to the due diligence, audit, and certification requirements described above, its Conflict Minerals Report also will have to describe:

- The products manufactured or contracted to be manufactured that have not been found to be "DRC conflict free";
- The facilities used to process the conflict minerals in those products;
- The country of origin of the conflict minerals in those products; and
- The efforts to determine the mine or location of origin with the greatest possible specificity.

The objective of the required private sector audit report is twofold: to express an opinion or conclusion as to whether: (i) the design of the company's due diligence framework, as set forth in the Conflict Minerals Report, with respect to the period covered by the 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 (ii) 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. The auditor does *not* need to express an opinion as to whether the due diligence measures were effective or whether the company's conflict minerals are "DRC conflict free."

Temporary "DRC Conflict Undeterminable" Category

The SEC adopted a temporary category of "DRC conflict undeterminable." For a two-year period (four years in the case of smaller reporting companies), if a company is unable to determine, after exercising the required due diligence, whether the conflict minerals in its products originated in the DRC or an adjoining country, or financed or benefitted armed groups in those countries, the company's Conflict Minerals Report would describe:

- Its products manufactured or contracted to be manufactured that are "DRC conflict undeterminable";
- The facilities used to process the conflict minerals in those products, if known;
- The country of origin of the conflict minerals in those products, if known;
- The efforts to determine the mine or location of origin with the greatest possible specificity; and
- The steps it has taken, or will take, if any, since the end of the period covered in its most recent Conflict Minerals Report to mitigate the risk that its necessary conflict minerals benefit armed groups, including any steps to improve due diligence.

During this transition period, companies are not required to obtain an independent private sector audit regarding the "DRC conflict undeterminable" products included in their Conflict Minerals Report.

After this transition period expires, if a company cannot determine the source of its conflict minerals, it will have to describe such products in its Conflict Minerals Report as not found to be "DRC conflict free." Companies are allowed to add additional disclosure or clarification to explain that "DRC conflict free" has a very specific meaning. Therefore, after the transition period expires, according to footnote 562 of the adopting release, the company, for example, could state:

> We have been unable to determine the origins of some of our conflict minerals. Because we cannot determine the origins of the minerals, we are not able to state that products containing such minerals do not contain conflict minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country. Therefore, under the federal securities laws we must describe the products containing such minerals as having not been found to be 'DRC conflict free.' Those products are listed below.

Other Exceptions

Outside of Supply Chain

Companies are not required to provide any information regarding conflict minerals that were located outside of the supply chain prior to January 31, 2013. Columbite-tantalite, cassiterite, and wolframite minerals, or their derivatives, are considered to be outside the supply chain after they have been smelted. Gold is considered outside of the supply chain after it has been fully refined. Moreover, any conflict minerals, or their derivatives, that have not been smelted or fully refined are considered to be outside the supply chain if they were located outside of the DRC or an adjoining country.

Acquisitions

If an SEC reporting company acquires another company that manufactures, or contracts to manufacture, products with conflict minerals that are necessary to the functionality or production of those products, that SEC reporting company will be permitted to delay reporting on the products manufactured by the acquired company until the end of the first reporting calendar year that begins no sooner than eight months after the effective date of the acquisition. This exception is applicable only if the acquired company had not been required to provide a Form SD with respect to its conflict minerals.

Form SD Technical Requirements

Form SD needs to be signed by an executive officer of the company, but there is no requirement that it be signed by any particular executive officer. If a Conflicts Minerals Report is required, it will be filed as an exhibit to the Form SD.

Form SD does not require a chief executive officer or a chief financial officer certification; as a filing that is separate from the company's annual report, the Form SD is not covered by the CEO or CFO certifications filed with a Form 10-K, Form 20-F, or Form 40-F. If a Conflict Minerals Report is required, the certification with respect to the audit does not need to be made directly by an officer—rather it is a certification of the company made as a statement in the Form SD disclosure.

All companies that are required to file a Form SD will do so on a calendar-year basis, regardless of their fiscal years. The Form SD needs to report the required information for the calendar year during which the manufacture of a product containing conflict minerals is completed,

regardless of whether the company manufactures the product itself or contracts to have the product manufactured. Form SD will be due by May 31 of each year, commencing May 31, 2014, with respect to the 2013 fiscal year.

A Form SD is deemed "filed" (as opposed to "furnished"), making the company subject to liability under Section 18 of the Exchange Act for false or misleading statements contained therein. However, it is not automatically incorporated into a registration statement under the Securities Act of 1933 (Securities Act).

Practical Considerations

Although the first Form SD will not be due until May 31, 2014, it will need to contain information with respect to the entire calendar year beginning January 1, 2013. Gathering the information necessary to determine whether the rule applies to the company, performing the reasonable country of origin inquiry, and, if necessary, undertaking the supply chain due diligence and arranging for a private sector audit required for a Conflicts Minerals Report can take a significant amount of time. Therefore, public companies promptly should begin their analyses of the application of the conflict minerals rule to their circumstances and formulate their plans for complying with the new disclosure requirements.

Compliance plans should include identifying the products that the company manufactures or contracts to manufacture that contain conflict minerals (even if only included in a component manufactured by others) and preparing appropriate representations to include in documentation to be obtained from suppliers. Private companies that manufacture products containing conflict minerals, as well as companies, public or private, that distribute products containing conflict minerals should be prepared to receive requests for representations as to the source of the conflict minerals in those products.

While the SEC has provided little direct guidance on how to ensure compliance with the country of origin inquiry aspect of the conflict minerals rule, US Customs law and procedure provides a benchmark for conducting an adequate country of origin inquiry. US Customs law requires US importers to take reasonable care in ensuring they are in compliance with rules governing importation into the United States. Because the United States often gives duty preferences to goods produced, manufactured or substantially transformed in particular countries, many importers are keenly aware of the challenging requirements that must be satisfied to prove that a good meets particular origin requirements. The methods used to ensure compliance with duty preference programs provide a useful starting point for ensuring compliance with the conflict minerals rule. Because US Customs rules of origin can be complex, companies that already rely on outside counsel and/or auditors to assist in US Customs inquiries will want to consider retaining such expertise in the conflict minerals context.

Companies that will be required to perform source and chain of custody due diligence should familiarize themselves with the applicable OECD framework.

Companies that are impacted by conflict minerals disclosure rule should determine which departments within their organizations need to be included in the disclosure process. These companies need to decide if they are adequately staffed, if they need to hire additional people or if they need to retain outside firms to address the new reporting responsibilities. To the extent the rule requires a company to obtain a private sector audit, the company should consider who it will retain for this purpose.

Companies that may need to file Form SD should develop a disclosure control procedure for this new requirement. Similarly, the Form SD filing should be added to their corporate compliance calendars.

Companies that are concerned about a negative impact from potential disclosures indicating that they cannot conclude specific products are "DRC conflict free" should consider whether a risk factor needs to be developed for their next quarterly report, annual report or Securities Act registration statement. They also may want to explore the possibility of alternative sources of supply.

Notes

1. *See* Release No. 34-67716, available at *http://www.sec.gov/rules/final.shtml.*
2. *See* Release No. 34-63547, available at *http://www.sec.gov/rules/proposed/proposedarchive/proposed2010.shtml.*
3. *See* Mayer Brown's Legal Update dated September 4, 2012, entitled *SEC Adopts Dodd-Frank Resource Extraction Payments Disclosure Rules* available at *http://www.mayerbrown.com/SEC-Adopts-Dodd-Frank-Resource-Extraction-Payments-Disclosure-Rules-09-04-2012/.*
4. *See* OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and *High-Risk Areas,* available at *http://www.oecd.org/daf/internationalinvestment/corporateresponsibility/oecdduediligenceguidanceforresponsiblesupplychainsofminerals fromconflict-affectedandhigh-riskareas.htm* and its *Supplement on Gold,* available at *http://www.oecd.org/daf/internationalinvestment/investmentfordevelopment/goldsupplementtotheduediligenceguidance.htm.*