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Legal Update
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US Securities and Exchange Commission Proposes New Disclosure Rules for Conflict Minerals, Mine Safety and Payments by Resource Extraction Issuers

On December 15, 2010, the Securities and Exchange Commission (SEC) voted to propose several rules mandated under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Among these were proposed rules relating to disclosures under the following sections of the Dodd-Frank Act: (i) section 1502 (conflict minerals) in Release No. 34-63547,[1] (ii) section 1503 (mine safety) in Release Nos. 33-9164 and 34-63547[2] and (iii) section 1504 (payments by resource extraction issuers) in Release No. 34-63549.[3]

The proposed rules cover a broader range of industry categories than their titles would indicate. Comments to the proposed rules must be received by the SEC by January 31, 2011.

Conflict Minerals

Scope. Section 1502 of the Dodd-Frank Act reflects Congress's position that the exploitation and trade of certain minerals originating in the Democratic Republic of the Congo (DRC) assists in the financing of conflict in that country, resulting in severe human rights abuses. Section 1502 added new Section 13(p) of the Securities Exchange Act of 1934, which provides that any person required to file reports with the SEC and for which "conflict minerals" are necessary to the functionality or production of a product manufactured (or contracted to be manufactured) by that person must disclose whether those conflict minerals originated in the DRC, or countries that share an internationally recognized border with the DRC. The DRC and these adjoining countries are referred to in the release as the "DRC countries."

These disclosure requirements apply to an extremely wide range of companies and industries, since the Dodd-Frank Act defines "conflict mineral" as any of the following raw materials, or their derivatives, commonly used in electronics, communication equipment and aerospace equipment:

- Gold (used in jewelry and electronics);
- Columbite-tantalite (coltan) (source ore for tantalum, which is used in electronic equipment, carbide tools, and jet engine components);
- Cassiterite (used to produce tin for alloys, tin plating, and solders for pipes and electronics); and
- Wolframite (used to produce tungsten, which is used in electronics, heating equipment, and welding).

In addition, the Dodd-Frank Act includes in its definition of conflict minerals any other mineral or its derivatives determined by the US Secretary of State to be financing conflict in DRC countries.

In response to industry concerns over the scope of the rules, particularly among consumer retailers, the SEC clarified in its release that the

disclosure requirements would not apply to issuers that only sell the products of third parties and that either (i) have no contract or other involvement regarding the manufacturing of such products or (ii) do not sell the products under their brand name or a separate brand name they have established and do not have the products manufactured specifically for them. By the same token, retailers that have influence over the manufacturing of the products they sell, such as private label products made specifically for them, would be subject to the reporting requirements of the statute.

The proposed rules would also apply to any product for which conflict minerals are necessary to its production even when the product itself does not contain conflicts minerals. Thus, taken literally, the proposed rules would appear to encompass an unbridled scope, arguably applying to any product for which electronics, for example, were a necessary component in the product's production. In addressing this concern, the SEC highlighted in the release some of the complex analysis demanded by the statute: "[C]onflict minerals necessary to the functionality or production of a physical tool or machine used to produce a product would not be considered necessary to the production of the product even if that tool or machine is necessary to producing the product."

The release explains, by way of example, that a car that does not contain conflict minerals would not fall within the scope of the disclosure requirements merely because a wrench used to build the car contains conflict minerals, even if those conflict minerals are necessary to the functionality of the wrench.

Disclosure Requirements. Under the proposed rules, if an SEC reporting company (regardless of size) has conflict minerals incorporated in its products or used (either by the reporting company or another person) to produce its products (including the mining of conflict minerals), the reporting company must conduct a "reasonable country of origin inquiry."

The proposed rules do not define the type of inquiry required, but the release states that the steps necessary to meet this requirement will "depend on available infrastructure at a given point in time" and, in any event, will not require absolute certainty as to whether conflicts minerals originated in DRC countries. The release explains that for the near term, until sources of information improve, a reasonably reliable representation made by the facility processing the conflict minerals will suffice, absent facts and circumstances rendering such representation untrustworthy.

Depending on the results of this inquiry, the proposed rules contemplate three categories of disclosure, one or more of which may apply to the issuer's conflict minerals. Disclosures made with regard to conflict minerals must be made for the fiscal year in which the issuer takes possession of such conflict minerals or a product produced using such conflict minerals. The conflict mineral disclosure requirement for US issuers is set forth in a proposed new Item 104 of Regulation S-K.

(1) Conflict minerals not originating from DRC countries. If the issuer determines that its conflict minerals did not originate from DRC countries, it must disclose that fact in its annual report under a separate heading entitled "Conflict Minerals Disclosure," along with a description of its inquiry and the address of its Internet website where it has posted a copy of the disclosure. The issuer must retain reviewable business records relating to its inquiry and maintain the disclosure posted on its website until it files its next annual report.

(2) Conflict minerals from DRC countries or of uncertain origin. If the issuer (i) determines that its conflict minerals originated from DRC countries or (ii) cannot make a determination whether its conflict minerals originated from DRC countries, then the issuer must furnish a Conflict Minerals Report as an exhibit to its annual report.

- This report will describe the issuer's measures taken to investigate the source and chain of custody of its conflict minerals, which must include a certified independent private sector audit of the report (conducted according to standards established by the US Comptroller General). The Conflict Minerals Report must identify the independent private sector auditor and include a copy of the audit report and the issuer's certification that this audit was obtained.
- The term "DRC conflict free" is used in the Dodd-Frank Act to refer to products that do *not* contain conflict minerals that directly or indirectly finance or benefit certain armed groups identified by the US State Department as perpetrators of serious human rights abuses in DRC countries. However, under the proposed rules, if the issuer is unable to determine the origin of the conflict minerals, they are not "DRC conflict free." For products manufactured or contracted to be manufactured that are not DRC conflict free, the Conflict Minerals Report must describe the facilities used to process those conflict minerals, the country of origin of the conflict minerals, and the issuer's efforts to determine the mine or location of origin of the conflict minerals with the greatest possible specificity.

The issuer also must state in the body of its annual report under "Conflict Minerals Disclosure" that the Conflict Minerals Report is attached as an exhibit and is also available on the issuer's website along with the independent private sector audit report. The issuer must maintain the posting of its Conflict Minerals Report and the independent private sector audit report on its website until the issuer files its next annual report.

(3) Conflict minerals from recycled or scrap sources. If the issuer determines that its conflict minerals were derived from recycled or scrap sources, it must make all of the disclosures described above for conflict minerals determined to originate from DRC countries, but with the following important variations:

- The issuer must furnish a Conflict Minerals Report (along with an independent private sector audit of the report); but, because the proposed rules deem conflict minerals from recycled or scrap sources to be "DRC conflict free," the issuer need not make the disclosures in the Conflict Minerals Report required for conflict minerals that are not DRC conflict free. In lieu of such disclosures, the issuer must state that the conflict minerals were obtained from recycled or scrap sources and are considered to be DRC conflict free, and must describe the due diligence measures taken to determine that its conflict minerals were from recycled or scrap sources.
- The issuer's statement in the body of its annual report under "Conflict Minerals Disclosure" must explain that the conflict minerals were obtained from recycled or scrap sources and that a Conflict Minerals Report has been furnished with regard to such conflict minerals.

Retailers, including Tiffany & Co., indicated in comments to the SEC that tracing the supply chain for gold, in particular, is challenging because bullion refiners often combine newly mined and recycled gold. In the release, the SEC states that the rules would still apply to such sources, explaining that the range of acceptable due diligence may "vary and evolve over time," and that, even when unable to fully trace the source of conflict minerals, an issuer must still provide as much of the required information as possible, including a description of its due diligence efforts. For conflict minerals with mixed sources, the issuer must apply the disclosure approach applicable to each portion of the minerals, which, depending on the circumstances, could result in an issuer providing varying degrees of disclosure for its conflict minerals.

Instructions to the proposed rules provide that the information required by the rules would be

"furnished" to, not "filed" with, the SEC and would not be incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act, except to the extent that the information is specifically incorporated by reference into a filed document. Thus, the "independent private sector auditor" that prepared the audit report would not assume expert liability under the Securities Act and the issuer would not be required to file a consent from that auditor.

Treatment of Foreign Private Issuers. The proposed rules would apply to foreign private issuers and require them to make the specified disclosures in their annual reports filed on Form 20-F or Form 40-F.

Effective Date. The Dodd-Frank Act currently requires issuers to make the required disclosures after the issuer's first full fiscal year following enactment of final rules. Assuming the final rules are issued in April 2011, it appears that a December 31 fiscal year-end filer would first be required to include the disclosures as part of its annual report for its fiscal year ending December 31, 2012.

Mine Safety

Scope. Section 1503 of the Dodd-Frank Act applies to issuers who are operators, or who have a subsidiary that is an operator, of a coal or other mine, as defined under the Federal Mine Safety and Health Act of 1977 (Mine Act). The Mine Act defines "operator" to include the operator, supervisor or controller of a mine (along with independent contractors performing services at such mine) and defines "coal or other mine" as any site located in the United States from which non-liquid minerals are extracted (or if liquid minerals, are extracted with workers underground) and certain appurtenant areas.

Most of the disclosure requirements relating to section 1503 are set forth in the Dodd-Frank Act and are currently in effect. The SEC's proposed Mine Safety Disclosure rules largely address implementation of section 1503's disclosure requirements and add only a limited amount of additional disclosure as indicated below.

Disclosure Requirements. The proposed rules would require the section 1503 disclosures to be made in Form 10-Ks, Form 10-Qs, Form 20-Fs and Form 40-Fs as to whether any mine safety matters exist and, if they do, to identify each mine for which the issuer or one of its subsidiaries is an operator and disclose:

- The total number of violations of mandatory health and safety standards that could significantly and substantially contribute to the cause and effect of a mine safety or health hazard under section 104 of the Mine Act for which the operator has received a citation from the Department of Labor's Mine Safety and Health Administration (MSHA);
- The total number of orders issued under section 104(b) of the Mine Act;
- The total number of citations and orders for unwarrantable failure of the operator to comply with mandatory health or safety standards under section 104(d) of the Mine Act;
- The total number of flagrant violations under section 110(b)(2) of the Mine Act;
- The total number of imminent danger orders issued under section 107(a) of the Mine Act;
- The total dollar value of proposed assessments from the MSHA under the Mine Act (the proposed rules would require the issuer to disclose the total dollar value of assessments proposed by the MSHA during the period covered by the report and the total dollar value of all outstanding assessments as of the last day of the period, regardless of whether the assessment was being challenged or appealed); and
- The total number of mining-related fatalities.

The proposed rules would also require disclosure of a list of the mines for which the issuer has received written notice from the MSHA of:

- A pattern of violations of mandatory health and safety standards (or the potential to have such a pattern) that could have significantly and substantially contributed to the cause and effect of mine health or safety hazards under section 104(e) of the Mine Act (the proposed rules would require a brief description of the category of such violations); and
- Any pending legal action (and any material developments in previously disclosed legal actions) before the Federal Mine Safety and Health Review Commission regarding such mines.

These proposed rules would require the issuer to disclose the party instituting the legal action, the date of institution, the name and location of the mine, and a brief description of the category of violation involved.

For US companies, these mine safety disclosure requirements would be contained in a new Item 106 of Regulation S-K.

The proposed rules also help implement section 1503(b) of the Dodd-Frank Act, and require issuers to file a report on Form 8-K under a proposed new Item 1.04 within four days of receipt of any of the following:

- An imminent danger order issued under section 107(a) of the Mine Act;
- A written notice from the MSHA of a pattern of violations of mandatory health or safety standards that could have significantly and substantially contributed to the cause and effect of mine health or safety hazards under section 104(e) of the Mine Act; or
- A written notice from the MSHA that the mine has the potential to have such a pattern.

The proposed rules relating to the new 8-K Item would require disclosure of the date of receipt, a brief description of the category of notice or order received and the name and location of the mine involved. The untimely filing of an Item 1.04 Form 8-K will not result in loss of Form S-3 eligibility.

In addition, the proposing release notes that to the extent mine safety issues are material, disclosures could also be required under current disclosure rules such as Regulation S-K's Items 303 (management's discussion and analysis), 503(c) (risk factors), 101 (description of business) and 103 (legal proceedings), regardless of whether the mine or mines are located in the United States.

Treatment of Foreign Private Issuers. For foreign private issuers, the proposed rules contemplate that the additional disclosures regarding mine safety to be provided in Form 20-F and Form 40-F will suffice and will not require such issuers to file current reports under Form 8-K or Form 6-K.

Effective Date. The section 1503 disclosures required by the Dodd-Frank Act are currently in effect, although the corresponding SEC rules are still in the proposed stage.

Payments By Resource Extraction Issuers

Scope. Section 1504 of the Dodd-Frank Act added section 13(q) to the Exchange Act, which requires a resource extraction issuer to disclose in its annual report information relating to any payment made by it (along with its subsidiaries or other entities under its control) during the fiscal year to a foreign government or the US government for the purpose of commercial development of oil, natural gas or minerals.

The Dodd-Frank Act defines "resource extraction issuer" to mean an issuer that (i) is required to file an annual report with the SEC and (ii) engages in the commercial development of oil, natural gas or minerals (which includes exploration, extraction, processing, export and other significant actions relating to oil, natural gas or minerals, or to the acquisition of a license for any such activity).

In its release, the SEC states that "commercial development" is not intended to capture activities that are ancillary and preparatory to commercial development, but only those that are directly

related to the commercial development of oil, natural gas, or minerals. By way of example, the SEC explains that the manufacture of drill bits or other machinery used in oil drilling would not be considered "commercial development." Pipeline transportation activities would likewise not be included in the definition; however, gathering and processing operations that remove impurities (e.g., sulfur, water or CO_2) from natural gas produced from the wellhead before transport through the pipeline would be considered necessary to commercial development and thereby included.

The Dodd-Frank Act defines "foreign government" as a foreign government, a department, agency or instrumentality of a foreign government, or a company owned by a foreign government, such as a national oil company. Under the proposed rules, the term also includes the government of a state, province, country, district, municipality or territory. A "company owned by a foreign government" is defined as a company that is at least majority-owned by the foreign government.

Under the Dodd-Frank Act, "payment" is defined as an amount paid that (i) is made to further commercial development of oil, natural gas or minerals, (ii) is not *de minimis* and (iii) includes taxes, royalties, fees (including licensing fees), production entitlements, bonuses and "other material benefits" that the SEC determines are part of the "recognized revenue stream" for commercial development. The proposed rule provides that taxes on corporate profits, corporate income and production must be disclosed, but taxes levied on consumption (such as value added taxes, personal income taxes and sales tax) need not be disclosed.

The "payments" definition under the release is an example of the Extractive Industries Transparency Initiative's (EITI) effect on the legislative history of section 1504 and the proposed rules. The EITI is a voluntary coalition formed in 2002 comprising: oil, natural gas and mining companies; foreign governments; investor groups; and other international organizations. It is dedicated to fostering and improving transparency and accountability in countries rich in oil, natural gas and minerals through the publication and verification of company payments and government revenues from oil, natural gas and mining. Many reporting oil and natural gas exploration and production companies (including major oil companies and many of the larger independents) are participants in the EITI.

Disclosure Requirements. If a resource extraction issuer makes any of these types of payments to a foreign government (or to the US government), the proposed rules require disclosure of certain information in two exhibits to the annual report—one in either HTML or ASCII format and the other in XBRL interactive data format. The issuer must also provide a statement in the body of its annual report under a heading entitled "Payments Made By Resource Extraction Issuers" that the required disclosures concerning payments to governments are included in these exhibits. The resource extraction disclosure requirements for US issuers are set forth in a new Item 4(c) of Form 10-K and proposed new Item 105 of Regulation S-K, and will require disclosure of:

- The type and total amount of payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas or minerals;
- The type and total amount of such payments made to each government;
- The total amounts of the payments, by category;
- The currency used to make the payments;
- The financial period in which the payments were made;
- The business segment of the resource extraction issuer that made the payments;
- The government that received the payments and the country in which the government is located; and

- The project of the resource extraction issuer to which the payments relate.

The release acknowledges that requiring disclosures of payments made to foreign government entities may violate confidentiality obligations and, in certain instances, that the host countries may prohibit any such disclosures. New section 13(q) added to the Exchange Act by Dodd-Frank Act section 1504 contains no provisions exempting these requirements for confidentiality obligation breaches or prohibition by host company law. The release solicits comments on whether exemptions from the proposed rules' requirements would be appropriate given the choice some registrants may have of either abandoning their projects in those countries or violating the registration provisions under the Exchange Act.

Instructions to the proposed rules provide that the information required to be disclosed would be deemed to be "furnished" to, not "filed" with, the SEC. Thus, except to the extent that the information is specifically and expressly incorporated by reference into a filed document, the disclosures under the proposed rules would not be subject to liability for misleading statements under Section 18 of the Exchange Act and would not be incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act.

Treatment of Foreign Private Issuers. The proposed rules would apply to foreign private issuers and require the specified disclosures to be contained in their annual reports filed on Form 20-F or Form 40-F.

Effective Date. Section 1504 of the Dodd-Frank Act requires an issuer to make the required disclosures in its annual report for its fiscal year that ends not earlier than one year after the date that the SEC issues its final rules. The SEC is required to adopt final rules on or before April 15, 2011. Assuming that the final rules are issued on April 15, 2011, it appears that the issuer must make the required disclosures in its annual report for its fiscal year that ends on or after April 15, 2012. Thus, for a US calendar fiscal-year filer, the disclosures would first be required in the issuer's Form 10-K for its fiscal year ended December 31, 2012.

Endnotes

[1] Available at http://sec.gov/rules/proposed/2010/34-63547.pdf.

[2] Available at http://sec.gov/rules/proposed/2010/33-9164.pdf.

[3] Available at http://sec.gov/rules/proposed/2010/34-63549.pdf.

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