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Dodd-Frank Conflict Minerals Disclosure Requirements Expected to Affect Thousands of Public Companies in 2012

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Beginning January 1, 2012, public companies will have to begin assessing their compliance with new "conflict minerals" disclosure requirements. For thousands of public companies, this will culminate in new disclosures in their annual reports on Form 10-K or 20-F, including, in some cases, an audited "Conflict Minerals Report." Although the SEC's rules have not been finalized, companies should begin evaluating their compliance responsibilities as soon as possible. The SEC has already missed its April 2011 deadline for adopting conflict minerals rules, and we expect the SEC to adopt final rules by year-end, which would be applicable for the 2012 reporting period.

Section 1502 of the Dodd-Frank Act directs the SEC to enact additional reporting requirements for companies regarding the use of "conflict minerals" from the Democratic Republic of Congo (DRC) and adjoining countries (the DRC countries). The term "conflict mineral" is defined as cassiterite, columbite-tantalite, gold, worlframite or their derivatives, or any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the DRC countries. There is no *de minimis* exception, so companies that use even trace amounts of relevant materials in their products or in their manufacturing process will be impacted.

Section 1502 is intended to stop the exploitation and trade of conflict minerals in the DRC, which Congress believes is helping to finance the conflict in the region. For years, various non-governmental organizations have sought to influence companies that use these minerals in their products to commit to source only conflict-free minerals. Section 1502 will require companies to disclose whether or not they use conflict minerals from DRC countries in their products. NGOs will then likely use public pressure to target companies that use or are unable to verify that they do not use conflict minerals to change their sourcing or improve supply chain controls.

The proposed SEC rules' broad reach is expected to affect many industries, including electronics, automotive, construction, medical equipment, industrial equipment and machinery, aerospace, lighting and jewelry. Depending on how the final rules are written, retailers and financial institutions may also be affected. A commercial bank, for instance, has stated that it expects to fall within the scope of the new rules because it issues credit cards that include covered elements. Retailers could be affected if they are involved in the manufacturing of products they carry or have products manufactured specifically for them. The SEC estimates that approximately 6,000 public companies will be affected, with industry groups predicting even higher numbers.

Summary of Rule

The proposed SEC rules would require that any reporting company that manufactures, or contracts for the manufacture of, a product for which conflict minerals are necessary to the functionality or production of that product to disclose in its annual report whether its conflict minerals originated in a DRC country. If so, or if the company is unable to determine the source of its materials, the company would be required to furnish a separate report as an exhibit to its annual report that includes, among other things, a description of the measures taken by the company to exercise due diligence on the source and chain of custody of its conflict minerals. The company would have to obtain, and certify, an independent private sector audit of its report, and make these reports available to the public on its website.

Step 1: Determining Issuers Covered by the Conflict Minerals Provision

In determining which companies are covered by the conflict minerals provision, the proposed rules contain a two-part test:

1. Does the company file reports with the SEC under Section 13(a) or Section 15(d) of the Exchange Act?
2. If so, are conflict minerals necessary to the functionality or production of a product manufactured by the company or a product contracted to be manufactured by the company?

If a company answers affirmatively to both, it would be subject to the conflict minerals provision. Many companies that would otherwise not expect to be covered by this rule could fall under the proposed rules.

- *Applicable to Foreign Private Issuers and smaller reporting companies* – The proposed rules do not include any exemptions for foreign private issuers or smaller reporting companies.
- "*Contract to Manufacture*" – The provision would apply to companies that contract for the manufacturing of products over which they have any influence regarding the manufacturing of those products. The rules would also apply to companies selling generic or other "branded" products under their own or a separate brand name, regardless of whether they have any influence over the manufacturing specifications of those products, as long as the company has contracted with another party to have the product manufactured specifically for it. While technically this may carve out a class of pure retailers, we expect that many retailers and other companies that are not traditionally viewed as manufacturers will be covered as a result of this "contract to manufacture" language.
- *Conflict Minerals as "Necessary" to a Product* – The SEC has solicited comments on whether it should define when a conflict mineral is "necessary" to the functionality or production of a product. Without defining what "necessary" means, the SEC notes that there is no *de minimis* exception if conflict minerals are necessarily used. The proposed rules also cover those products in which conflict minerals are used and necessary to the production process, but not included anywhere in the final product. The rules are not intended to cover a situation, however, where conflict minerals are necessarily used in a tool or machine necessary for the production of a product. For example, if a wrench is used in the production of a widget, the widget manufacturer would not need to provide disclosures on the presence of conflict minerals in the wrench.
- *Applicable to Mining Companies* – The proposed rules cover mining companies when they extract conflict minerals.

Step 2: Determining Whether Conflict Minerals Originated in DRC Countries and the Resulting Disclosure

If the company is determined to be covered by the conflict mineral provision, it will be required to determine if the conflict material originated in a DRC country and provide subsequent disclosure.

Standard for Disclosure

- *Standard for Disclosure Requires Reasonable Country of Origin Inquiry* – Under the proposed rules, a company would have to make a reasonable country of origin inquiry as to whether its conflict minerals originated in the DRC countries. The rules do not, however, specify what constitutes a "reasonable country of origin inquiry"

because the SEC believes such an inquiry would depend on each company's particular facts and circumstances.

- *Reasonable Country of Origin Inquiry depends on Available Infrastructure* – Further, the SEC recognizes that the steps necessary to constitute a reasonable country of origin inquiry depend on the available infrastructure at a given point in time. The SEC notes that companies could satisfy the required diligence by receiving reasonably reliable representations from the facility at which its conflict minerals were processed that those conflict minerals did or did not originate in the DRC countries. For example, a company may reasonably rely on a facility's representations regarding the source of its conflict minerals if the smelter was identified as one that processes only "DRC conflict-free" minerals under recognized national or international standards. The SEC cautions, however, as systems for tracking conflict minerals improve, smelter certifications and supplier declarations may not satisfy a reasonable country of origin inquiry standard.
- *Companies May Not Avoid Disclosure with a "No Evidence" Finding* – An industry group suggested that a company should not have to provide additional information if it concludes from its inquiry that there is "no evidence" that its conflict minerals originated in the DRC countries. While the SEC acknowledges that a company that may conduct a reasonable country of origin inquiry and not be able to ascertain with absolute accuracy the origins of the conflict minerals, the SEC will require these companies to file a Conflict Minerals Report and exercise a greater level of investigation into the source and chain of custody of its conflict minerals. The SEC will allow these companies, though, to disclose they are unable to determine that their conflict minerals did not originate in the DRC countries in their disclosure.

Location of Disclosure

Under the proposed rules, if a company concludes that its conflict minerals **did not** originate in the DRC countries, it will be required to:

- disclose its determination in the body of its annual report and on its Internet website; and
- disclose its reasonable country of origin inquiry in the body of its annual report.

If a company concludes that any of its conflict minerals originated in the DRC countries or if it is unable to determine after a reasonable country of origin inquiry that any of its conflict minerals did not originate in the DRC countries, it will be required to:

- disclose its determination in the body of its annual report and on its Internet website; and

- furnish a Conflict Minerals Report as an exhibit to its annual report and make the report available on its Internet Web site.

Step 3: Conflict Minerals Report's Content and Supply Chain Due Diligence

If a company has determined that any necessary conflict minerals originated in the DRC countries or is unable to determine that they did not, under the proposed rules, the company will be required, as part of their Conflict Minerals Report, to:

1. exercise due diligence on the source and chain of custody of its conflict minerals and describe the diligence it exercised;
2. describe its "supply chain determinations"; and
3. certify that it obtained an independent private sector audit and furnish it as part of the Conflict Minerals Report.

Due Diligence

The SEC's proposed rules do not include a specific due diligence standard or otherwise provide guidance concerning the due diligence a company would be required to perform in making its supply chain determinations. Instead, the SEC notes that prescribing particular guidance for due diligence would be inappropriate because the conduct undertaken by a reasonably prudent person may vary and evolve over time. Companies will be required to disclose the conduct they performed in reaching their supply chain determinations. The SEC expects that a company that conforms its conduct to a nationally or internationally recognized set of standards of, or guidance for, due diligence regarding conflict minerals supply chains would satisfy the requirement to use due diligence in making supply chain determinations.

The SEC specifically notes the Organisation for Economic Cooperation and Development's (OECD) due diligence guidance for conflict minerals supply chains. The guidance suggests five steps:

- establish strong company management systems;
- identify and assess risk in the supply chain;
- design and implement a strategy to respond to identified risks;
- carry out an independent third-party audit of supply chain due diligence at identified points in the supply chain; and

- report on supply chain due diligence.

More information is available at [http://www.oecd.org/dataoecd/62/30/46740847.pdf.](http://www.oecd.org/dataoecd/62/30/46740847.pdf)

Certain NGOs that have been encouraging companies to adopt responsible sourcing of conflict minerals in the DRC countries, including the Enough Project and Global Witness, have also provided guidance on this topic.

Supply Chain Determinations

Under the proposed rules, within the Conflict Minerals Report, a company must provide its findings. These "supply chain determinations" consist of:

- a description of the company's products that are not "DRC conflict free;"
- the facilities used to process those conflict minerals;
- the country of origin of those conflict minerals; and
- the efforts to determine the mine or location of origin with the greatest specificity.

The SEC notes that products are "DRC conflict free" when those products do not contain conflict minerals that directly or indirectly finance or benefit armed groups in the DRC countries. A company's description of any of its products that are not "DRC conflict free" should be based on its individual facts and circumstances so that the description sufficiently identifies the products or categories of products. For example, a company may disclose:

- each model of a product containing conflict minerals that are not "DRC conflict free";
- each category of product containing conflict minerals that are not "DRC conflict free";
- the specific products containing conflict minerals that are not "DRC conflict free" that were produced during a specific time period;
- that all of its products contain conflict minerals that are not "DRC conflict free"; or
- any other description depending on the company's facts and circumstances.

A company that provides a Conflict Minerals Report because it is unable to determine that its conflict minerals did not originate in the DRC countries must also provide this information. A company in this situation that has undertaken an appropriate due diligence review on the source and chain of custody of its conflict minerals may explain in the report that although certain products may be labeled as not "DRC conflict free," the company has been unable to determine the source of the conflict minerals.

A number of industry resources are available to assist in compliance, and we can provide a list upon request.

Independent Private Sector Audit

A company must furnish an independent private sector audit as part of the Conflict Minerals Report and specifically identify the auditor. The audit must be conducted in accordance with standards established by the Comptroller General of the United States.

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The final rules adopted by the SEC may differ from the proposed rule. Nevertheless, we believe that public companies should begin to evaluate their compliance responsibilities as soon as possible. The approach that each company takes will vary based on its industry and other unique characteristics. We would be happy to help you develop a compliance plan.

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