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Navigating the SEC's Recently Finalized Conflict Mineral Rules

September 21, 2012

On August 22, 2012, the U.S. Securities and Exchange Commission adopted its final rules implementing Section 1502 of the Dodd-Frank Act. The rules require a reporting issuer to disclose, in a report filed annually with the SEC, whether it includes "conflict minerals" originating in the Democratic Republic of Congo (DRC) or surrounding countries in the products it manufactures or contracts to manufacture. Conflict minerals include columbite-tantalite (coltan), cassiterite, gold and wolframite, which are used in many applications across industries, as detailed in Appendix A.

The SEC estimates that approximately 6,000 issuers will be affected by the final rules. While the SEC made changes to the final rules that will ease compliance, they remain complex and in many cases will require an issuer to conduct significant diligence into its manufacturing processes, and to file reports describing its efforts, subject in some cases to audit requirements and, in all cases, to potential liability under the federal securities laws.

Although not directly subject to the new rules, thousands of private companies that serve as business partners of public companies will unavoidably be called upon to assist in the latters' due diligence efforts to identify the sources of conflict minerals. Private investment funds may find it prudent to monitor the compliance of their portfolio investments, including any impact on products and supply chains, and the market reaction to related public disclosures.

Why Is There a Conflict Minerals Rule?

Congress enacted Section 1502 of the Dodd-Frank Act based on information that the exploitation and trade of conflict minerals by armed groups is helping to finance conflict and human atrocities in the DRC and surrounding countries. The legislation reflects the view that public disclosure will discourage companies from purchasing minerals where the proceeds may unwittingly assist armed groups in and around the DRC. Section 1502 directed the SEC to adopt rules to implement its requirements.

Which Companies Must Comply with the New Rules?

The rules apply to any company that files reports with the SEC under Section 13(a) or Section 15(d) of the Exchange Act. The rules are applicable to domestic companies, foreign private issuers and smaller reporting companies. Although the SEC had received a number of comments requesting exemptions for foreign private issuers and smaller reporting companies from these rules, the agency chose not to exempt these categories of issuers. In the final rules, the SEC did provide a temporary relaxation of the requirements for issuers that are unable to determine the origin of their conflict minerals after conducting due diligence, as discussed below.

The final rules on their face appear also to apply to issuers that file reports voluntarily under an indenture or other contractual obligation, despite language in Section 1502 that the requirements apply to issuers that are "required to" file periodic reports.

As noted above, the conflict mineral rules will also impact thousands of private companies that are not directly subject to the new rules. Public companies will look to their suppliers and other business partners to assist in identifying, researching, and potentially certifying the contents of their products, and the source of any conflict minerals. Depending on the circumstances, private investment funds should monitor how their portfolio investments are impacted.

When Are Issuers First Subject to the Rules?

Due to the extensive advance preparation that reporting could entail, many issuers have already started to evaluate their obligations under the new rules, although the first report is not due to be filed until May 31, 2014, covering the period from January 1, 2013 through calendar year-end. All issuers must report on a calendar year basis, even if they do not report their financial results based on the calendar year.

While all issuers must evaluate their reporting obligations under the new rules on an annual basis, not all issuers ultimately will see any changes to their filed reports as a result of the new rules, depending on a number of factors, including whether they manufacture products, or contract to manufacture products, that use the specified "conflict minerals." The appropriate analysis is outlined below under "ThreeStepProcessforDeterminingHowToComply."

In considering whether an issuer may have to file reports under the new rules, it is important to keep in mind that the rules do not include a *de minimis* exception. The SEC feared that such an exception would be contrary to the language of Section 1502, although the agency had received many comments on the proposed rules urging that it adopt one. Thus, even a trace or *de minimis* amount of conflict minerals can trigger disclosure obligations for an issuer if those conflict minerals are necessary for the functionality or production of a product.

What Form Must Be Filed?

The rules require that issuers meeting threshold conditions provide disclosure on a new Form SD that is filed with the SEC on May 31st in the next succeeding year following the year covered by the report. As a result, the first Form SD will be required to be filed on May 31, 2014 with respect to calendar year 2013. The Form SD will include principally a description of the issuer's efforts to determine whether or not it uses conflict minerals. In certain situations, issuers will be required to prepare a separate Conflict Minerals Report, which is attached as an exhibit to Form SD. The issuer may be required to obtain a "private sector" audit of the Report, and the nature of the audit is described more fully below under "Audit Requirements."

Because the Form SD is filed, and not furnished, any disclosures included in it, or attached to it, are subject to potential liability under Section 18 of the Exchange Act. The Form SD, however, does not require CEO or CFO certifications and does not become automatically incorporated by reference into an issuer's registration statements.

How Does an Issuer Determine Its Obligations under the New Rules?

The rules seek to provide issuers with flexibility to apply them in the context of different types and sizes of issuers, and different industries. While providing flexibility, the rules lack clear and certain standards for analysis. Many key terms in the rules are not defined, and the issuer is instructed to apply a facts and circumstances analysis, along with some degree of subjective judgment, in applying them.

However, the SEC has facilitated the analysis by providing a three-step framework. First, an issuer must determine whether it is subject to the reporting requirements under the new rules, which determination is generally based on actual use of the specified conflicts minerals in the manufacture of products. If the issuer is not subject to such reporting requirements, then no filing is required for that calendar year. In the second step, an issuer that determines it is subject to reporting under the rules must proceed to conduct an inquiry to determine whether the minerals may have derived from a covered region in Africa (and not from scrap or recycled metal), and prepare a report on Form SD. Based on that inquiry, the issuer may or may not have to advance to the third step, which is to conduct more thorough due diligence into the origins of the minerals, and to disclose such diligence and its results in a separate Conflict Minerals Report.

These three steps are detailed immediately below.

Three-Step Process for Determining How To Comply

The new rules incorporate a three-step process for issuers to analyze their obligations under the rules as follows:

Step 1: Do the Rules Apply to My Company?

The rules apply to an issuer that uses conflict minerals if:

- the issuer files reports with the SEC under Section 13(a) or Section 15(d) of the Exchange Act;

- the issuer uses any one or more of the specified conflict minerals in a product "manufactured" or "contracted to be manufactured" by the company, and the specified minerals are "necessary to the functionality or production" of the product; and

- the product is not "outside the supply chain" prior to January 31, 2013.

Since Step 1 incorporates defined terms, the SEC's release adopting the final rules discusses how these terms should be interpreted, as follows:

"*Manufacture*" *and* "*Contract to Manufacture*"

The new rules apply to issuers that "manufacture" their products. The SEC does not define the term "manufacture," stating that the "term is generally understood." The SEC does provide some guidance, however, in noting that "an issuer that only services, maintains, or repairs a product containing conflict minerals" is not manufacturing that product. For example, certain servicing and repair functions performed by jewelry retailers would not be captured by the term "manufacture." Nor do we believe the rules would capture other maintenance industries, such as automotive or aircraft maintenance and repair.

The rules also apply to issuers that "contract to manufacture" their products. The SEC does not define this term either, but rather takes the view that it is a fact and circumstances inquiry as to "the degree of influence exercised by the issuer on the manufacturing of the product." An issuer is considered to contract to manufacture a product if it exerts influence over the materials, parts, ingredients or components to be included in its products. The level of influence necessary to trigger the requirement is unclear, but presumably the "contract to manufacture" language would not be triggered unless the issuer's input has an impact on a material feature of the product, such as its functionality or specifications, such as size or appearance (other than it labeling as described below). On this subject, the SEC has clarified that it will not view an issuer as contracting to manufacture a product if the issuer's actions involve only:

1. specifying or negotiating contractual terms with a manufacturer that do not directly relate to the manufacturing of the product (for example, training or technical support, price, insurance, indemnity, intellectual property rights or dispute resolution); or

2. fixing its 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 final rule thus reflects the efforts by the retail sales industry to avoid coming within the scope of the rules by virtue of selling private label or "generic" merchandise manufactured by a third party. The SEC largely acquiesced to these efforts, but even retail issuers could become subject to the rules if they have influence over a product's final characteristics other than its labeling. For example, if a retail issuer sells a pre-existing product that is manufactured by a third party, but asks for modifications to the size, color, or other characteristics, it may be viewed as having "contracted to manufacture" the product. In the adopting release, the SEC stated that if an issuer with generic products includes its brand name or a separate brand name but has other involvement in the manufacturing of the product, it must consider all facts and circumstances in determining whether its influence reaches such a degree so as to be considered contracting to manufacture that product. Many issuers that would otherwise not be considered manufacturers will likely still have to engage in this facts and circumstances analysis.

The SEC narrowed the scope of the rules in another respect, as compared to its original proposals. The adopting release clarified that the rules do not apply to mining-only issuers. Issuers that are only engaged in mining activities are not covered by the rules, unless the mining issuer engages in manufacturing, either directly or through contract, in addition to mining.

"*Necessary to the Functionality or Production*"

The rules provide that an issuer must engage in a facts and circumstances analysis in determining whether a conflict mineral that it uses in the "manufacture" or "contract to manufacture" of a product is also "necessary to the functionality" of a product or "necessary to the production" of a product.

As a preliminary matter, the adopting release specifies that the conflict mineral must be contained in the product (and intentionally added to it) to trigger a determination that a conflict mineral is necessary to functionality or production of a product. Thus, if the conflict mineral is used as a catalyst or in another similar manner in the production process, but is not contained in the product that enters the stream of commerce, it should not be considered "necessary to the functionality or production" of such product, absent other factors. Accordingly, the SEC also noted that the use of tools, machines and other equipment (e.g., computers or power lines) containing conflict minerals to produce a product does not cause the product to come within the scope of the rules, if the minerals are not also added to the product itself.

The SEC outlined a number of factors in the adopting release for issuers to consider that would suggest that a conflict mineral is necessary to the functionality or production of a product, including that the conflict mineral is:

1. contained in and intentionally added to the product or any component of the product and is not a naturally occurring by-product;

2. necessary to the product's generally expected function, use or purpose; and/or

1. incorporated for purposes of ornamentation, decoration or embellishment, and whether the primary purpose of the product is ornamentation or decoration.

"*Outside the Supply Chain Prior to January 31, 2013*"

The rules do not require issuers to report on conflict minerals that were outside of the supply chain prior to January 31, 2013. Outside the supply chain, for the purposes of the rules, means (i) in the case of tantalum, tin and tungsten, the conflict minerals were smelted prior to that date, (ii) in the case of gold, the conflict minerals were refined prior to that date, or (iii) if neither smelted nor refined, the conflict minerals are physically located outside of the covered countries prior to that date.

* * *

If an issuer determines that for the calendar year in question it did not "manufacture" or "contract to manufacture" a product containing conflict minerals, or if it did so, that the use of conflict minerals is not "necessary to the functionality or manufacture" of the product, or that the products were outside the supply chain prior to January 31, 2013, then it is unnecessary to advance to Step 2, and no filings are required for that calendar year. If it reaches the opposite conclusion, then it must continue to Step 2, described below.

Step 2: Determination of Origin of Conflict Minerals

If an issuer determines that it is subject to the rules based on use of conflict minerals as necessary to its products, as described in step 1 above, it must conduct a good faith "reasonable country of origin inquiry" that is reasonably designed to determine if such conflict minerals originated in a covered country and/or are not derived from recycled or scrap sources.

Reasonable Country of Origin and/or Scap or Recycled Metal Inquiry

The rules provide that an issuer's country of origin inquiry must be performed in good faith and reasonably designed to determine if its conflict minerals originated in the covered countries, or came from recycled or scrap sources. The SEC notes that a reasonable country of origin inquiry can differ among issuers based on the issuer's size, products, relationships with suppliers and other factors. The SEC provides limited guidance on this point.

In a change from the proposed rules, the adopting release incorporates a reasonable belief standard into the inquiry. In other words, an issuer does not need to determine with certainty that its conflict minerals did not originate in the covered countries or come from recycled or scrap sources; it can conclude otherwise following a reasonable inquiry, unless there are "red flags" or other circumstances indicating that its conflict minerals may have originated in the covered countries, or did not come from recycled or scrap sources. In the proposed rules, the issuer would have had to reach a level of certainty that its conflict minerals did not originate in the covered countries or come from recycled or scrap sources in order to avoid moving to Step 3.

We believe that some of the most significant and useful guidance from the adopting release is that issuers may rely on reasonable representations from a mineral processing facility or the issuer's immediate suppliers within the supply chain in conducting their reasonable country of origin and scrap or recycled metal inquiries. The SEC states that it will view an issuer as having conduct a reasonable country of origin inquiry if it seeks and obtains reasonably reliable representations regarding the facility at which its conflict minerals were processed indicating that those conflict minerals did not originate in the covered countries or came from recycled or scrap sources. Such representations can come either directly from such facility or indirectly through the issuer's immediate suppliers. The issuer, however, must have reason to believe these representations and also must take into account any applicable warning signs or other circumstances indicating that its conflict minerals may have originated in the covered countries or may not have come from recycled or scrap sources. Specifically, the SEC provides that issuers are permitted to reasonably rely on representations stating that certain mineral smelters or processing facilities are "conflict-free" upon designation by certain recognized industry groups, or based upon an independent private sector audit that is made publicly available. The Electronic Industry Citizenship Coalition and the Global e-Sustainability Conflict-Free Smelter Program is one example of industry group designation and we expect that other industry and trade groups may develop similar or complementary programs and coordination efforts over time.

In addition to relying directly on representations from smelters and mineral processing facilities, we recommend that issuers, where practicable, consider implementing contract flow-down provisions or other written commitments with their suppliers. Flow-down provisions would require the supplier to source only DRC conflict-free minerals and to obtain similar representations and commitments from its own suppliers. Issuers also should consider adopting policies regarding the sourcing of conflict minerals. The SEC has stated that these policies can form part of the issuer's reasonable country of origin inquiry and would be helpful in drafting the issuer's Form SD disclosures.

In all cases, once the issuer has conducted a reasonable country of origin (or scrap/recycled metal) inquiry, it must describe its inquiry and conclusions on Form SD, as follows:

Required Disclosure on Form SD Following Inquiry

If, based on its reasonable country of origin inquiry, an issuer:

1. determines that its conflict minerals did not originate in the covered countries or did not come from recycled or scrap sources; or

1. has no reason to believe that its conflict minerals originated in the covered countries or it reasonably believes that its conflict minerals are from recycled or scrap sources,

then the issuer is required to disclose on Form SD its determination along with the nature of its reasonable country of origin (and/or recycling or scrap metal) inquiry on Form SD. In these cases, the issuer will have no further diligence obligations. If the issuer cannot reach one of the above conclusions, it will have to advance to Step 3, and exercise further due diligence on its conflict minerals, as discussed below.

Step 3: Exercising Due Diligence and the Conflict Minerals Report

Issuers that advance to Step 3 are required to conduct due diligence to determine the source of their conflict minerals and their role in financing or benefiting armed groups in the covered countries. In exercising due diligence on the source and chain of custody of its conflict minerals, an issuer is required to follow a nationally or internationally recognized due diligence framework. The SEC believes that as a result of following a framework, auditors will have a standardized structure against which they can comparatively assess due diligence procedures among different issuers. While leaving open the possibility that other frameworks may be developed, the SEC has pointed to only one such framework, the "Due Diligence Guidelines for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas" (the OECD Framework) of the Organization for Economic Cooperation and Development is currently available to issuers.

If, after exercising further due diligence, the issuer concludes that either its conflict minerals did not originate in the covered countries or that its conflict minerals did come from recycled or scrap sources, it must describe its reasonable inquiry and its further due diligence efforts, including the results and conclusions, on Form SD. The issuer also must post this information on its Web site and include a hyperlink to the information on its Form SD. It need not prepare a Conflicts Mineral Report.

If, on the other hand, the issuer cannot conclude either that its conflict minerals did not originate in the covered countries or that its conflict minerals came from recycled or scrap sources, it must file a Conflict Minerals Report, post the Conflict Minerals Report on its Web site and include a hyperlink from the Web site to the Conflict Mineral Reports on its Form SD.

Conflict Minerals Report

The Conflict Minerals Report identifies whether the issuer's products are "DRC conflict free" and describes the measures the issuer has taken to diligence the source and chain of custody of its conflict minerals, and use of such minerals in financing or benefiting armed groups in the covered countries. In order to identify a product as "DRC conflict free," an issuer must conclude that such product "does not contain minerals necessary to the functionality or production of that product that directly or indirectly finance or benefit armed groups" in a covered country. Further, it must comply with the following audit and certification requirements:

1. obtain a "private sector" audit of the Conflict Minerals Report;

1. certify that it obtained such private sector audit;

1. include the audit report as part of the Conflict Minerals Report filed on Form SD; and

1. identify the auditor.

If an issuer cannot describe one or more of its products as "DRC conflict free," then in addition to the audit and certification requirements described above, and subject to the temporary transition rules described immediately below, it also must describe the following in its Conflict Minerals Report:

1. the products manufactured or contracted to be manufactured that have not been found to be "DRC conflict free;"

1. the smelter or refinery used to process the conflict minerals in those products;

1. the country of origin of the conflict minerals in those products; and

1. the efforts to determine the mine or location of origin with the greatest possible specificity.

DRC Conflict Undeterminable; Transition Period

For a temporary two-year period (or four-year period for smaller reporting companies), starting in calendar year 2013, if the issuer is unable to determine whether the conflict minerals in its products originated in covered countries or financed or benefited armed groups in those countries following its due diligence efforts, it may describe its products as "DRC conflict undeterminable." The issuer is not required to obtain an independent private sector audit of the Conflict Minerals Report regarding the conflict minerals in those products. However, the issuer must describe the following in its Conflict Minerals Report:

1. the products manufactured or contracted to be manufactured that are "DRC conflict undeterminable";

1. the smelter or refinery used to process the conflict minerals in those products, if known;

1. the country of origin of the conflict minerals in those products, if known;

1. the efforts to determine the mine or location of origin with the greatest possible specificity; and

1. the steps it has taken or will take, if any, since 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.

Audit Requirements

As discussed above, the rules require that an issuer obtain a private sector audit of its Conflict Minerals Report. The "private sector" audit should be conducted in accordance with the standards established by the Comptroller General. The staff of the Government Accountability Office indicated to the SEC that existing standards would be applicable for the private sector audit, such as the standards for Attestation Engagements or the standards for Performance Audits. The OECD framework provides that ISO-certified firms with appropriate expertise may be engaged to perform the private sector audit, as would accounting firms registered with the Public Company Accounting Oversight Board.

The SEC has clarified that the objective of the audit is to express an opinion as to whether the design of the issuer's due diligence framework is in conformity, in all material respects, with the criteria set forth in the nationally or internationally recognized due diligence framework used by the issuer, and whether the issuer's description of its due diligence as disclosed in the Conflict Minerals Report is consistent with the due diligence process that the issuer actually undertook. The SEC also noted that it would not be inconsistent with the independence requirements in Rule 2-01 of Regulation S-X if the issuer's independent public accountant performs the independent private sector audit of the Conflict Minerals Report. Such an engagement, however, would be considered a "non-audit service" subject to pre-approval under Rule 2-01(c)(7) of Regulation S-X. Further, the fees related to the audit of the Conflict Minerals Report would need to be included in the "All Other Fees" category of principal accountant fees disclosure included in the issuer's periodic reports filed with the SEC.

M&A Transactions Where the Target Has Covered Products

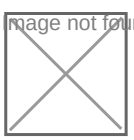
The rules also provide special treatment in the context of acquisitions. An issuer that acquires a private company that manufactures or contracts for the manufacturing of covered products may delay reporting on the acquired company's products until the end of the first reporting calendar year that begins no sooner than eight months after the effective date of the acquisition.

APPENDIX A

What Are Conflict Minerals?

The SEC has defined the term "Conflict Minerals" to include columbite-tantalite (coltan), cassiterite, gold, wolframite, and certain of their derivatives, which are limited to tantalum, tin, and tungsten unless the Secretary of State determines that additional derivatives are financing conflict in the DRC or an adjoining country (Covered Countries). See Figure 1. These minerals are widely used in a variety of industries.

Map Below of Democratic Republic of Congo and Adjoining Countries, and Table on Conflict Minerals



Mineral	Uses	Affected Industries
Cassiterite (Tin)	Alloys, tin plating, solders for joining plates and circuits.	Electronics, automotive, industrial equipment and construction
Columbite-tantalite (Tantalum)	Electrical components for mobile telephones, computers, videogame consoles, and digital cameras, and as an alloy for making carbide tools and jet engine components.	Electronics, medical equipment, industrial tools and equipment and aerospace
Gold	Jewelry, electric plating and wiring.	Jewelry, electronics and aerospace
Wolframite (Tungsten)	Metal wires, electrodes, and contacts in lighting, electronic, electrical, heating, and welding applications	Electronics, lighting and industrial machinery

In addition to the minerals identified above, the rules also apply to any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the covered countries. As of the date of this memorandum, the Secretary of State has not designated any other minerals as conflict minerals. We do not expect the Secretary of State to designate any other minerals as conflict minerals prior to the first report that issuers will need to file in 2014.

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