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The SEC's New Rules Requiring Annual Disclosure of the Use of Conflict Minerals

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The Securities and Exchange Commission (SEC) recently adopted, by a 3-to-2 vote, final rules requiring reporting issuers to disclose annually the use of certain "conflict minerals" originating in the Democratic Republic of the Congo (DRC) and adjoining countries (collectively, the Covered Countries). Under the new rules, each SEC reporting company must disclose its use of conflict minerals if the minerals:

- originated in one of the Covered Countries; and
- are "necessary to the functionality or production of a product" manufactured, or contracted to be manufactured, by the company.

"Conflict minerals" include columbite-tantalite (a precursor to tantalum that is also known as coltan), cassiterite (a precursor to tin), gold, wolframite (a precursor to tungsten), or certain of these minerals' derivatives, including tantalum, tin and tungsten.

Subject companies must make the required disclosure with respect to the 2013 calendar year on new Form SD not later than May 31, 2014. Due to the many uses of these conflict minerals, the SEC estimates the final rules will affect approximately 6,000 reporting companies.

The SEC set forth in the new rules a three-step analysis to guide issuers through compliance with the disclosure requirements. The first step is to determine whether a company is a reporting issuer that manufactures or contracts to manufacture products for which conflict minerals are necessary to those products' functionality or production. The second step requires an issuer to determine whether such conflict minerals originated in a Covered Country and are not from scrap or recycled sources. The third step requires the issuer to exercise due diligence to determine if the conflict minerals financed or benefited armed groups in a Covered Country and to file with the SEC a Conflict Minerals Report, which may be required to be audited by an independent auditor.

The SEC's new rules implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was enacted to address concerns that the exploitation and trade of conflict minerals is helping to finance violent conflict in the DRC and contributing to an emergency humanitarian situation.

"Conflict Minerals"
Under the new rules, "conflict minerals" include columbite-tantalite (a precursor to tantalum that is also known as coltan), cassiterite (a precursor to tin), gold, wolframite (a precursor to tungsten), or certain of these minerals' derivatives, including tantalum, tin and tungsten (according to the SEC, the "only economically significant derivatives of the conflict minerals"), as well as any other mineral determined by the Secretary of State to be financing conflict in the Covered Countries, whether or not they actually financed or benefitted armed groups.

The following are common uses of these minerals:

- cassiterite is a metal ore that is most commonly used to produce tin and is used in alloys, tin plating, and solders for joining pipes and electronic circuits;
- columbite-tantalite is a metal ore from which tantalum is extracted, and tantalum is used in electronic components, including mobile telephones, computers, video-game consoles, and digital cameras, and as an alloy for making carbide tools and jet engine components;
- gold is used for making jewelry and also is used in electronic, communications, and aerospace equipment; and
- wolframite is a metal ore used to produce tungsten, which is used for metal wires, electrodes, and contacts in lighting, electronic, electrical, heating, and welding applications.

Step One: Determine Whether Conflict Minerals Are Used in the Issuer's Products
Issuers that meet all of the following conditions will need to comply with these new rules:

- the issuer files reports with the SEC under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (including foreign private issuers);
- the issuer manufactures or contracts to manufacture a product; and
- conflict minerals are "necessary to the functionality or production" of such product.

The final rules apply to products manufactured or contracted to be manufactured by a reporting company. An issuer is considered to be "contracting to manufacture" a product if it has some actual influence over the manufacturing of its products. This determination will be based on the degree of influence the issuer exercises over the materials, parts, ingredients or components in a product containing conflict minerals. The SEC expressly states that an issuer will not be deemed to "contract to manufacture" a product if its actions are limited to:

- specifying or negotiating contractual terms with a manufacturer that do not directly relate to the manufacturing of the product;
- affixing its brand, logo, label or marks to a generic product manufactured by a third party; or
- servicing, maintaining or repairing a product manufactured by a third party.

The determination of whether a conflict mineral is deemed "necessary to the functionality or production" of an issuer's product will depend on facts and circumstances pertaining to the issuer. In analyzing whether a conflict mineral may be "necessary to the functionality" of a product, the issuer should consider:

- whether the conflict mineral is contained in and 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 the conflict material is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration.

Based on the facts and circumstances, any of these factors, either individually or in the aggregate, may be determinative as to whether conflict minerals are "necessary to the functionality" of a given product.

In analyzing whether a conflict material may be "necessary to the production" of a product, the issuer should consider:

- whether the conflict mineral is contained in the product and intentionally added in the product's production process, other than if it is included in a tool, machine or piece of equipment used to produce the product; and
- whether the conflict mineral is necessary to produce the product.

For a conflict mineral to be deemed necessary to the production of a product, the conflict mineral must be contained in the final product. A conflict mineral used as a necessary catalyst to produce the product will not be deemed "necessary to the production' of the product unless some quantity, even a trace amount, of that conflict material ends up as a part of the manufactured product.

The final rules exempt conflict minerals that were "outside the supply chain" prior to January 31, 2013. Minerals will be deemed to be outside the supply chain before that date if they have been smelted or fully refined or, if they have not been smelted or fully refined, if they are located outside of the Covered Countries.

An issuer is required to provide disclosure whenever it determines that a conflict mineral is necessary to the functionality or production of a product it manufactures or contracts to manufacture, regardless of whether the issuer has determined the source of the conflict mineral.

Step Two: Conduct a Reasonable Country of Origin Inquiry

If an issuer has determined that one or more of its products contains conflict minerals, it must conduct a "reasonable country of origin inquiry" as to each of the conflict minerals in the subject products. The SEC does not prescribe the specific steps necessary to satisfy this inquiry but instead requires the inquiry to be performed in good faith and reasonably designed to

determine whether the conflict minerals necessary to the functionality or production of the issuer's product originated in the DRC or a country that shares an internationally recognized border with the DRC or are from recycled or scrap sources. Conflict minerals from recycled or scrap sources are treated as if they did not originate from a Covered Country.

The SEC will consider an issuer to have satisfied the reasonable country of origin inquiry if the issuer seeks and obtains reasonably reliable representations from its supplier or processing facility identifying the facility at which its conflict minerals were processed and indicating that those conflict minerals did not originate in a Covered Country or that they came from recycled or scrap sources.

Following the reasonable country of origin inquiry, if the issuer

- knows that its conflict materials did not originate in a Covered Country or knows that they came from recycled or scrap sources,
- has no reason to believe its conflict minerals may have originated in a Covered Country, or
- reasonably believes its conflict minerals came from recycled or scrap sources,

then, in all such cases, the issuer must only file a Form SD with the SEC that discloses its determination, describes briefly the reasonable country of origin inquiry it undertook and the results of the inquiry. The issuer would not be required to exercise due diligence on the source or chain of custody of its conflict minerals or file a Conflict Minerals Report with respect to such conflict minerals as provided in Step 3 below.

Step 3: Conduct Additional Due Diligence; Draft Conflict Minerals Report

If following its reasonable country of origin inquiry, the issuer

- knows or has reason to believe its conflict minerals originated in a Covered Country, and
- knows or has reason to believe that its conflict minerals did not come from recycled or scrap sources,

then the issuer must undertake due diligence on the source and chain of custody of its conflict minerals, following a "nationally or internationally recognized framework"

- to determine source of the conflict minerals, and
- if the conflict minerals came from a Covered Country, whether the minerals financed or benefited armed groups.

To satisfy the due diligence requirement, the framework employed by the issuer must have been established by a body or group that has followed due-process procedures, including disseminating the framework broadly for public comment, and be consistent with the standards in the Government Auditing Standards established by the U.S. Government Accountability Office. While the final rule does not mandate a particular framework, the SEC recognized the "Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and

High-Risk Areas" of the Organisation for Economic Cooperation and Development ("OECD") as satisfying its criteria. The SEC indicated that, while other frameworks are currently in development, the OECD framework is the only nationally or internationally recognized due diligence framework currently in existence.

If the source and chain of custody due diligence leads the issuer to determine that the conflict minerals originated in a Covered Country or that the issuer cannot determine the source of its conflict minerals, the issuer must prepare and file a Conflict Minerals Report as an exhibit to its report on Form SD relating to each conflict mineral for which that determination is made. The Conflict Minerals Report also must be posted on the issuer's website.

A Conflict Minerals Report must include a description of the measures the issuer took to exercise due diligence on the source and chain of custody of the conflict minerals contained in the issuer's product. In most circumstances, the issuer also is required to have an independent private-sector audit of the issuer's Conflict Minerals Report conducted in accordance with standards established by the Comptroller General of the United States. The object of the audit is to express an opinion as to (i) whether the design of the issuer's due diligence framework is in material conformity with the criteria set forth in the nationally or internationally recognized due diligence framework used by the issuer and (ii) whether the issuer's description of its due diligence measures as set forth in the Conflict Minerals Report is consistent with the process the issuer undertook with respect to the period covered by the report. The Conflict Minerals Report must include a certification that such audit has been completed, as well as a copy of the audit report.

Acknowledging that the processes for tracing conflict minerals through the supply chain may need further development before an issuer can make a definitive determination on their source, the final rule provides that, for a two-year temporary period (four years for smaller reporting companies), an issuer may conclude that its products are "DRC conflict undeterminable" after exercising due diligence. The final rules define "DRC conflict undeterminable" to mean, with respect to any product manufactured or contracted to be manufactured by an issuer, a product where the issuer is "unable to determine, after exercising due diligence…whether or not such product qualifies as DRC conflict free." Under the final rules, "DRC conflict free" means that a 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. An issuer that concludes that its products are "DRC conflict undeterminable" must describe in its Conflict Minerals Report the steps it has taken or will take, if any, to mitigate the risks that its conflict minerals benefit armed groups identified in annual U.S. State Department reports.

Period Covered and Initial Due Date

All issuers required to file conflict minerals information must do so on a new Form SD, which must be filed with the SEC by May 31 with regard to the previous calendar year. The first reports on Form SD will be due May 31, 2014.

Liability for Conflict Minerals-Related Disclosures

Unlike the proposed rule, the final rule provides that reports on Form SD and Conflict Minerals Reports will be "filed" with the SEC. Consequently, an issuer will be subject to liability under Section 18 of the Securities Exchange Act if its Form SD or Conflict Minerals Report contains false or misleading material statements. However, an issuer will not be liable for any

misstatements in a filed document if it can prove it acted in good faith and had no knowledge that the statement complained of was false or misleading.

Consistent with the proposed rule, the final rule provides that reports on Form SD and Conflict Minerals Reports (including the audit report) will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, including registration statements, unless the issuer chooses to specifically incorporate those reports by reference.