LEGAL UPDATES

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SEC Adopts Disclosure Rules for Conflict Minerals

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On August 22, 2012, the Securities and Exchange Commission (SEC) voted 3-2 to adopt a new rule that requires certain companies to disclose information concerning their use of "conflict minerals" that originate in the Democratic Republic of the Congo (DRC) or an adjoining country. Companies will be required to provide this disclosure on a new Form SD to be filed with the SEC beginning May 31, 2014, and to make that information publicly available on the company's website.

The new rule implements Section 1502 of the Dodd-Frank Act, which directs the SEC to promulgate rules requiring a company "with conflict minerals that are necessary to the functionality or production of a product manufactured by such person to disclose annually whether any of those minerals originated in the Democratic Republic of the Congo or an adjoining country." The section was enacted to address the concern that the exploitation and trade of conflict minerals by armed groups in the DRC region were contributing to a humanitarian crisis.

The following is a summary of key provisions of the new rule.

Scope of the Rule

Conflict minerals currently consist of four minerals – cassiterite, columbite-tantalite, gold and wolframite – plus three commonly used derivatives (tantalum, tin and tungsten). Any other minerals or derivatives that the U.S. secretary of state determines in the future to be financing conflicts in the covered countries are automatically added to the definition of conflict minerals. An SEC press release provided examples of products in which conflict minerals are commonly used – ranging from jewelry to metal wiring to lighting.

The rule applies to companies that rely on any conflict minerals if that company:

Uses those minerals in a way that is "necessary to the functionality or production of a product" the company manufactured or contracted to be manufactured.

Files reports with the SEC under the Securities Exchange Act of 1934 (whether domestic or foreign and including smaller reporting companies).

The new rule does not define some other key terms – "necessary to the functionality," "necessary to the production" or "contracted to manufacture." Instead, the SEC indicated that companies should make a facts and circumstances determination but provided some guidance. For example:

The SEC noted that the determination of whether a company has contracted to manufacture should be based on the degree of influence the company exerts over the manufacture of a product.

Specifically, in guidance helpful to large retail companies that sell products manufactured by third parties, the SEC indicated that a company would not be deemed to have contracted to manufacture where it only:

Affixes its brand, marks, logo or label to a generic product manufactured by a third party.

Specifies or negotiates contractual terms with a manufacturer that do not directly relate to the manufacturing of the product.

Services, maintains or repairs a product manufactured by a third party.

The SEC indicated that, in determining whether the conflict minerals are "necessary to the functionality," companies should consider whether:

The mineral is "contained in" and "intentionally added" to a product or component, rather than a naturally occurring by-product.

Whether the mineral is necessary to the product's generally expected function, use or purpose.

If the mineral is incorporated for "ornamentation, decoration or embellishment," the primary purpose of the product is decoration or ornamentation.

The SEC further suggested that a mineral that is used as a catalyst is not "necessary to the production" of a product unless it is contained (even in trace amounts) in the product.

The SEC declined to define "manufacture," noting that the term is generally understood, but it clarified that it would not include activities limited to servicing, maintaining and repairing.

The rule excludes from coverage:

Conflict minerals that are smelted or fully refined or moved outside the covered countries before January 31, 2013.

Any company that mines conflict minerals unless it also engages in manufacturing.

The SEC **declined to exempt** companies that use only minimal amounts of conflict minerals. So, even small amounts of a conflict mineral will trigger the additional due diligence inquiries.

First Step – Use of Conflict Minerals

Each company subject to the new rules must determine whether any conflict mineral is necessary to the functionality or production of a product that the company manufactures or contracts for manufacture. If so, the company must conduct other inquiries described below and must file Form SD with the SEC with specific detail on its conflict minerals.

Because Form SD is filed with the SEC, companies will be subject to liability under Section 18 of the Exchange Act for any "false or misleading" statements in their Form SD, subject to a defense if the company acted in good faith and did not have knowledge that the information was false and misleading. Officers need not certify the Form SD (unlike Forms 10-K and 10-Q), and Form SD is not incorporated into the company's registration statements under the Securities Act of 1933, unless specifically added.

Recycled and Scrap Source Minerals

To encourage the continued use of recycled or scrap materials, the new rule includes special treatment for conflict minerals from a covered country **if** derived from recycled or scrap sources. Therefore, if a company's conflict minerals are obtained from recycled or scrap sources, the company may qualify its products as "DRC conflict free" (described in more detail below). If, however, after its reasonable inquiry, the company cannot reasonably conclude that its conflict minerals come from recycled or scrap sources, it must move to the next stage of inquiry and exercise due diligence to determine the origin of the minerals.

Second Step – Reasonable Country of Origin Inquiry

If a company determines that conflict minerals are necessary to the functionality or production of a product the company manufactures or contracts to be manufactured, the company must conduct a "reasonable" inquiry to determine the country in which the minerals originated. The rule does not prescribe the steps necessary to satisfy this requirement, only that the inquiry must be performed in good faith and be reasonably designed to determine whether the minerals originated in a "covered country." Covered countries include the DRC and adjoining countries – currently, Angola, Burundi,

Central African Republic, the Republic of the Congo, Rwanda, South Sudan, Tanzania, Uganda and Zambia.

The SEC indicated that a company will satisfy the inquiry standard if it receives from the facility or the company's supplier "reasonably reliable representations indicating the facility" where conflict minerals were processed are not located in a covered country, as long as the company has reason to believe the representations are true, given the surrounding facts and circumstances – including any "warning signs" that the materials originated in a covered country. The SEC explained that receipt of "a 'conflict-free' designation by a recognized industry group that requires an independent private sector audit" for a facility will constitute "reason to believe" a certification from a facility.

If a company has determined that its conflict minerals did not originate in a covered country *or* its minerals came from scrap or recycled sources that originated in a covered country, the company must describe the inquiry and its conclusion on Form SD that is filed with the SEC and disclose the information on its website. The company need not proceed with the third step.

Third Step – "DRC Conflict Free" or Not "DRC Conflict Free"

If a company determines that the conflict minerals might have originated in a covered country and may not have come from scrap or recycled sources, the company must conduct due diligence on the source and chain of custody of the minerals and detail its findings in a Conflicts Minerals Report as an exhibit to its Form SD. The company must also disclose this information on its website.

In its Conflict Minerals Report, the company must include a description of the due diligence measures used to determine the source and chain of custody of its conflict minerals. These due diligence measures must conform to a nationally or internationally recognized due diligence framework, if one is available. The SEC noted that it was aware of only one such framework, the due diligence guidance for gold approved by the Organization for Economic Cooperation and Development (OECD), available at http://www.oecd.org/corporate/guidelinesformultinationalenterprises/FINAL%20Supplement%20on%20Gold.pdf.

If, after investigation, a company determines that its products are "DRC Conflict Free" – that the conflict minerals did not finance or benefit armed groups – the company must obtain an independent private sector audit to confirm its conclusion and include the audit in its Conflict Minerals Report filed with its Form SD and posted on the company's website. As noted above, this audit is not required for products derived from recycled or scrap materials.

If a company's products are not all "DRC conflict fee," the Conflict Minerals Report must also include a description of:

Any products that have not been found to be "DRC conflict free" (including those products with an undeterminable origin).

The facilities used to process the conflict minerals in those products.

The country of origin of those minerals.

The efforts to determine the mine or location of origin of those minerals with the greatest possible specificity.

The adopting release included a "flowchart" designed to illustrate the steps in the process required by the new rules.

Timing of Implementation

All companies are required to provide information about their conflict minerals on a calendar year basis – regardless of the company's fiscal year. The filing on Form SD will be due to the SEC on May 31 of the following year. Companies must comply with the rule for the 2013 calendar year, with the first Form SD due to be filed on or before May 31, 2014.

The SEC also adopted final rules that affect publicly reporting companies involved in exploration, extraction, processing or export of oil, natural gas or minerals or acquiring licenses to conduct those activities. These companies must provide detailed disclosure of payments to governments on a project by project basis, also on the new Form SD, beginning for calendar year companies, for the period from October 1, 2013, through December 31, 2013.

Temporary Relief

For two years (four years for smaller reporting companies), companies that are unable to determine whether the minerals used in its products benefitted armed groups may describe those products as "DRC conflict undeterminable." Instead of providing an independent audit, the company must identify the following information in its Conflict Minerals Report:

The products found to be "DRC conflict undeterminable."

The facilities used to process the conflict minerals in those products, if known.

The country of origin, if known.

Efforts used to determine the mine or location of origin of those minerals with the greatest possible specificity.

Steps planned or taken, if any, to mitigate the risk that the conflict minerals benefit armed groups, including any steps to improve due diligence since the end of the last period covered in the company's latest Conflict Minerals Reports.

What This Means to You

Companies that manufacture or contract for the manufacture of products should:

Begin to identify the best process to determine whether conflict minerals are used in their supply chains.

Carefully document these efforts to identify whether conflict minerals are included in products.

If conflict minerals are used, promptly begin the due diligence inquiry on country of origin and recycled materials.

Taking these steps now will help ensure that companies will have the information necessary when the new Form SD must be filed in May 2014.

Contact Info

For additional information about this or any other securities and corporate governance subject, please contact your Husch Blackwell attorney.

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