

Client Alert

Latham & Watkins Corporate Department

SEC Adopts "Conflict Minerals" Rules

On August 22, the Securities and Exchange Commission voted 3-2 to adopt new rules implementing the so-called "conflict minerals" requirements of Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Dodd-Frank Section 1502 added Section 13(p) to the US Securities Exchange Act of 1934, which broadly mandates SEC-reporting companies to make disclosures and undertake due diligence if they are involved in manufacturing products containing conflict minerals.

This *Client Alert* briefly summarizes these new requirements. Many issues remain unresolved, and even though the SEC provided interpretive guidance in the Adopting Release,¹ we expect significant further guidance from the SEC Staff.

Required Disclosure for Conflict Minerals

Newly adopted Rule 13p-1 is deceptively simple — it provides that all SEC registrants "having conflict minerals that are necessary to the functionality or production of a product manufactured or contracted by that registrant to be manufactured" must file a newly required form (Form SD), which, depending on the circumstances, can entail short-form reporting or long-form audited disclosure. Rule 13p-1 applies to all SEC-reporting companies, including foreign private issuers.²

What are conflict minerals and where are they found?

Form SD defines conflict minerals as gold, tantalum, tin and tungsten, unless the US Secretary of State determines that additional derivatives of the ores from which tantalum, tin and tungsten are derived (*i.e.*, columbite-tantalite (coltan), cassiterite or wolframite), are being used to finance conflict in the Democratic Republic of the Congo (the DRC) or an adjoining country. An adjoining country for these purposes means a country that shares an internationally recognized border with the DRC. This currently includes Angola, Burundi, Central African Republic, the Republic of Congo, Rwanda, South Sudan, Tanzania, Uganda and Zambia.

- **Gold** is used in jewelry and adornment for consumer items and as a component in the aerospace, communications, electronic and medical industries. The DRC is not a major producer of gold, but Tanzania was a top 20 producer of gold in 2010.

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- **Tantalum** is a derivative of columbite-tantalite, known as coltan, which is used as a component in many electronics devices including cellular telephones, computers and cameras, as well as in industrial tools and aerospace parts. Rwanda and the DRC were top 10 producers of columbite-tantalite in 2010.
- **Tin** is a derivative of cassiterite ore and is used the electronic, packaging and automotive industries. The DRC was one of the top 10 producers of tin in 2011.
- **Tungsten** is a derivative of wolframite ore and is used in industrial machinery (especially in the construction, mining and drilling industries), and as a component in electrical and electronic applications, including semiconductors. Rwanda and the DRC produce tungsten.

What does manufacture or contract to manufacture mean?

Rule 13p-1 and Form SD do not define manufacture or contract to manufacture. However, the Adopting Release stated that the SEC would not consider an issuer that only “services, maintains or repairs a product containing conflict minerals” to be engaged in manufacturing.³

The question whether an issuer contracts to manufacture depends on the “degree of influence exercised by the issuer on the manufacturing of the product based on the individual facts and circumstances surrounding an issuer’s business and industry.”⁴ A company would not be viewed as contracting to manufacture a product if its actions involve no more than:

- specifying or negotiating contractual terms with a manufacturer that do not directly relate to the manufacturing of the product, such as training or technical support, price, insurance, indemnity, intellectual property rights, dispute resolution or other like terms or conditions concerning the product, “unless the issuer specifies or negotiates taking these actions so as to exercise a degree of influence over the manufacturing of the product that is practically equivalent to contracting on terms that directly relate to the manufacturing of the product;”
- affixing 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.⁵

Stockpiles of materials or components which have already been refined or smelted before January 1, 2013 are considered “outside of the supply chain” and therefore not subject to Rule 13p-1.⁶ In addition, a company engaged only in mining will not be deemed engaged in manufacturing or contracting to manufacture minerals unless the company also engages in manufacturing.⁷

What is the meaning of necessary to the functionality, of a product or production process of a product?

Rule 13p-1 and Form SD do not define “necessary to the functionality or production of a product.” The Adopting Release states that a company determining whether conflict minerals are necessary to the functionality of a product should consider:

- whether a 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 a conflict mineral is necessary to the product’s generally expected function, use or purpose; and
- if a conflict mineral is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration.⁸

To determine whether conflict minerals are necessary to the production of a product, a company should consider:

- whether a conflict mineral is contained in the product and intentionally added in the product’s production process, including the production process of any component of the product; and

- whether the conflict mineral is necessary to produce the product.⁹

The SEC did not adopt a *de minimis* exception and expressly acknowledged that this would make Rule 13p-1 and Form SD more costly for companies to implement.¹⁰

Form SD

Form SD is due on May 31 after the end of a company's most recent fiscal year beginning January 1, 2013.¹¹

Conflict Minerals Disclosure and Conflict Minerals Report

Companies must file either a short-form "Conflict Minerals Disclosure" or a lengthier "Conflict Minerals Report." To determine which obligation a company must follow, it must conduct a "reasonable country of origin inquiry" designed to determine "whether any of the conflict minerals originated in" the DRC or an adjoining country or whether they are from a recycled or scrap source.¹² The possible outcomes are:

- If the company determines that its conflict minerals are DRC conflict free — meaning that they did not originate in the DRC or an adjoining country or that they came from recycled or scrap sources — and has no reason to believe otherwise, it must disclose its determination and "briefly describe the reasonable country of origin inquiry it undertook"¹³ on Form SD in a Conflict Minerals Disclosure and provide a link to its website where the disclosure is publicly available. The Conflict Minerals Disclosure does not require an independent private sector audit. The determination need not be certain, but the process undertaken should be reasonably designed and in good faith.
- If the company determines that its necessary conflict minerals *did* originate in the DRC or an adjoining country or the company has reason to believe, based on its reasonable country of origin inquiry, that conflict minerals in its supply chain originated in the DRC or an adjoining country, it must exercise due diligence on the source and chain of custody of its conflict minerals and make additional disclosures about its diligence efforts and the results of that diligence in the form of a Conflicts Mineral Report included as an exhibit to Form SD.¹⁴

If a Conflicts Mineral Report is required, it must include "an independent private sector audit" of the company's due diligence measures.¹⁵ The purposes of the audit are to "express an opinion or conclusion as to whether the design" and description of the company's due diligence measures are in conformity with the due diligence framework the company used.

Transitional relief

During 2013 and 2014 (2013-2016 for smaller reporting companies), issuers may omit the independent private sector audit report of its Conflicts Minerals Report with respect to any conflict minerals that are "DRC conflict undeterminable."¹⁶ A finding of DRC conflict undeterminable can result when either:

- a company cannot factually determine, after a reasonable country of origin inquiry and supply chain due diligence, whether the conflict minerals present in its supply chain that originated in the DRC or an adjoining country financed or benefited armed groups in such countries; or
- a company is unable to determine, after these steps, whether it has reason to believe the conflict minerals in its supply chain may have originated in the DRC or an adjoining country, but it is unable to determine the geographic provenance of the conflict.¹⁷

Beginning with 2015 (2017 for smaller reporting companies), issuers with DRC conflict undeterminable minerals must describe those products as not having been found to be "DRC conflict free," and must provide an independent private sector audit.

What is a reasonable country of origin inquiry?

Rule 13p-1 and Form SD do not define what constitutes a reasonable country of origin inquiry. The Adopting Release states that a reasonable inquiry "can differ among issuers based on the issuer's size, products, relationships with suppliers, or other factors."¹⁸ However, the inquiry must be "designed to determine whether the issuer's conflict minerals did originate" in the DRC or adjoining countries, or "did come from recycled or scrap materials, and it must be performed in good faith."¹⁹ The SEC also stated that it would view a company "as satisfying the reasonable country of origin inquiry standard if it seeks and obtains reasonably reliable representations indicating the facility at which its conflict minerals were processed and demonstrating that those conflict minerals did not originate in" the DRC or adjoining countries, or came from recycled or scrap sources.²⁰ These representations could come "either directly from that facility or indirectly" through a company's immediate suppliers, but the company must have "a reason to believe these representations are true given the facts and circumstances surrounding those representations."²¹

What is a nationally or internationally recognized due diligence framework?

Rule 13p-1 and Form SD do not require companies to use any specific due diligence framework. The Adopting Release states that the framework "must have been established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment, and be consistent with the criteria standards" in Government Auditing Standards (GAGAS) established by the General Accounting Office (the GAO).²² The OECD's "Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas" is a due diligence framework that satisfies the SEC's requirements and may be used by companies.²³ However, the Adopting Release recognizes that companies may adopt different approaches to due diligence with respect to diverse elements of their supply chain, including different methodologies for disparate conflict minerals within the same supply chain.²⁴

Which auditing and auditor independence standards apply?

The SEC has deferred to the GAO in the development of standards for the audit of the required Conflict Minerals Report. The Adopting Release noted that GAO has informed the SEC Staff that existing GAGAS standards, "such as the standards for Attestation Engagement or the standards for Performance Audits will be applicable."²⁵ Similarly, the SEC declined to adopt auditor independence standards and deferred to the GAO.

Conclusion

Beginning in fiscal year 2013, the conflict minerals rules will impose substantial due diligence and disclosure requirements on a broad range of public companies. The ultimate cost and burden of these requirements remains to be seen, but the impact on many public companies may be substantial. Public companies should closely monitor developments from the SEC and industry groups as these new rules become a reality.

Endnotes

¹ See *Conflict Minerals*, Release No. 34-67716 (August 22, 2012) [hereinafter Adopting Release].

² *Id.* at 113.

³ *Id.* at 153.

⁴ *Id.* at 156.

⁵ *Id.* at 159.

⁶ *Id.* at 129.

⁷ *Id.* at 173.

⁸ *Id.* at 224.

⁹ *Id.*

¹⁰ *Id.* at 245.

¹¹ Form SD, General Instruction B.

¹² *Id.*, Item 1.01(a).

¹³ *Id.*, Items 1.01(b), 1.01(c)(4)

¹⁴ *Id.*, Item 1.01(c).

¹⁵ *Id.*, Items 1.01(c)(1)(ii).

¹⁶ *Id.*, Instruction 2 to Item 1.01.

¹⁷ *Id.*, Item 1.01(d)(v).

¹⁸ *Adopting Release* at 446.

¹⁹ *Id.*

²⁰ *Id.* at 148

²¹ *Id.*

²² *Id.* at 207.

²³ *Id.* at 196.

²⁴ *Id.* at 208.

²⁵ *Id.* at 650.

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