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News from our Securities Regulation Group

SEC's Final Rules on Conflict Minerals Disclosure Expected to Have Broad Impact

On August 22, 2012, the SEC, by a vote of three to two, adopted final regulations, mandated by Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, governing public company disclosure of the use of "conflict minerals" originating in the Democratic Republic of the Congo and adjoining countries. Conflict minerals are used in, or in the manufacture of, a wide range of electronic products, including laptops, mobile phones, PDAs, DVD players, digital cameras, gaming devices and televisions, as well as in medical devices, airplanes, cars, machine tools, jewelry, packaging for food products and a whole host of other products. As a result, these new rules are likely to have a surprisingly broad impact.

Background

Section 1502 of Dodd-Frank was enacted to help address the exploitation and trade of conflict minerals (gold and the three T's, tin, tungsten and tantalum), which fuel and finance "conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contribut[e] to an emergency humanitarian situation…." According to a recent GAO report, http://goo.gl/s4Ol9, mandated by Dodd-Frank, a survey conducted in the eastern DRC in 2010 estimated that 9% of the population had experienced some form of sexual violence in just the one-year period from March 2009 through March 2010.

The ability of armed groups to fund this violence by trading in conflict minerals can be largely attributed, say sponsors of the legislation, to the public appetite in the U.S. and elsewhere for computer tablets, cell phones and other electronic gadgets. The apparent objective of these provisions is to neutralize the effect of this demand and thus help curtail this violence by enhancing public awareness of the sources of conflict minerals used in companies' products. Presumably, public awareness will drive consumer demand and development of processes to certify that products are "DRC conflict free," as has been the case with development of the Kimberley Process in the certification of diamonds as conflict free. Even now, advocacy groups, such as The Enough Project from the Center for American Progress, have begun to rank companies based on their efforts to use conflict-free minerals in their products. http://goo.gl/ZlXQR. The new rules, along with public demand for conflict-free products, are expected to encourage public companies that use conflict minerals to leverage their collective buying power to pressure their suppliers through their entire supply chains to provide minerals that are "DRC conflict free." In addition, the disclosure is designed to allow investors to better assess each company's reputational and supply chain risk.

Despite the praiseworthy objectives underlying Section 1502, however, the prospective costs and many challenges involved in compliance with the provision have fueled significant controversy surrounding the rulemaking. Large conglomerates, while supportive of the provision's humanitarian aspirations, have protested the difficulty of tracking and tracing minerals used in hundreds of thousands of parts acquired from thousands of suppliers, while smaller companies are often less able to bear the costs or even carry out the rules' complex mandates. More recently, a series of high profile op-eds have compounded the controversy, igniting debate over whether the rules will actually mitigate the violence ravaging the war-torn region or, despite all laudable intentions, further devastate the DRC by inadvertently creating a *de facto* boycott of minerals from the area.

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Controversy notwithstanding, there have been some reports of progress made in tamping down the violence in eastern DRC. A new report http://goo.gl/H3JyY from The Enough Project, based on field interviews in the DRC and Rwanda, found that, because of the prospective application of Section 1502 as well as technology industry sourcing policies, armed groups in eastern DRC have experienced an approximate 65% decrease in profits from trading in conflict minerals over the past two years. The report also attributed a 75% decrease in size over the same period of a notorious rebel group operating in eastern DRC to the impact of this financial strain, coupled with military pressure. An October 2011 letter to the SEC from the U.N. Group of Experts on the DRC indicated that "requiring companies to exercise due diligence is effective. The Group's investigations in the DRC have shown that private sector purchasing power and due diligence implementation is reducing conflict financing, promoting good governance in the DRC mining sector, and preserving access to international markets for impoverished artisanal miners."

While, as suggested above, a number of high-technology companies and industry groups have been developing processes to verify that suppliers use conflict-free minerals, the exercise has not been easy, even with the resources available to large companies acting collectively. Conflict minerals may be smuggled across borders, melted down and mixed at smelters with minerals from other countries and then sold through a variety of intermediaries via long and tangled supply chains that traverse a number of countries. The fact that control over the mines by armed groups may shift back and forth compounds these challenges, and extended periods of unrest in the DRC have, from time to time, hampered international campaigns to curb trading by tracking the origin of minerals. Moreover, most companies are just at the beginning of a steep learning curve regarding the relatively novel types of inquiries required under the new rules. Over time, companies and industry organizations may need to establish new supply chain systems that could involve tracking technology, certificates of custody, transaction records, contractual agreements and independent auditing of facilities. It remains to be seen whether companies, trade organizations or third-party providers will be successful in developing simple and widely available mechanisms to trace the origins of the conflict minerals they use and whether Section 1502 and these final SEC rules on conflict minerals will ultimately have the effect of dampening violence in the DRC as Congress intended.

The SEC's new regulations, long overdue and well beyond the SEC's comfort zone, were a tough assignment for the SEC to tackle. To assist in this rulemaking effort, the SEC took into account over 400 public comment letters, held more than 140 private meetings with a broad variety of stakeholders and hosted a public roundtable with panelists representing a mix of socially responsible investment funds, companies, NGOs, consultants and auditors. However, the question remains whether the SEC's cost-benefit analysis, defects in which led the courts to overturn the SEC's proxy access rules in 2011, will suffice to avert a threatened court challenge to these new rules by the Chamber of Commerce and others. The open meeting at which the new rules were adopted may have set the table for that challenge, as the two dissenting commissioners made plain their views that, while the SEC's cost-benefit analysis may have addressed the identifiable costs (estimated at $3 billion to $4 billion for the initial cost of compliance), the SEC staff failed to quantify the benefits or assess how effective the rules will be in achieving those benefits, which are largely humanitarian. That the SEC staff lacked the data and expertise to even conduct such an assessment simply lent credence to their view that, Congressional mandate aside, the securities laws were not the proper venue—and the SEC not the proper agency—to promulgate rules addressing these humanitarian goals.

The new rules, available at http://goo.gl/aXulQ, require public companies to assess annually whether any "conflict minerals" are "necessary to the functionality or production of a product" manufactured by the company and potentially to disclose whether the minerals in products originated in the DRC or an adjoining country (referred to as the "covered countries") and whether the products are DRC conflict free. Importantly, conflict minerals that are "outside the supply chain" (that is, they have been smelted or fully refined or are otherwise located outside the covered countries) prior to January 31, 2013 are exempt from the final rules.

Although the deadline for filing the first Form SD is not until May 31, 2014 (covering calendar 2013), preparation of Form SD, and performance of all of the work that is a necessary predicate to it, will require a substantial investment of time and energy. We recommend that companies that believe they might use conflict minerals begin now to contact their trade organizations and industry groups to find out if any actions have been taken or are proposed by those groups that might be of benefit in connection with the new requirements. In addition, companies may want to review applicable resource materials identified in links in this *Alert*.

The remainder of this *Alert*, in question-and-answer format, is a summary of the final rules.

Summary of the final rules

Under the final rules, SEC reporting companies that manufacture products (or contract to have products manufactured) will be required to navigate through a three-step process devised by the SEC involving various and sometimes elaborate levels of due diligence and disclosure, depending on the use and origin of conflict minerals:

Step One: Each company will need to determine whether any conflict minerals are "necessary to the functionality or production of a product" manufactured by the company or contracted by the company to be manufactured. If not, the rules will not apply, and no disclosure or other action will be required.

Step Two: If the rules are applicable, the company will then be required to conduct a "reasonable inquiry" to determine the country of origin of the conflict minerals. (Note that the definition of "conflict minerals" refers to the specified minerals or derivatives—gold, tin, tungsten and tantalum—regardless of their country of origin.) One method of conducting a reasonable country-of-origin inquiry is to obtain reasonably reliable representations, from the smelter or other processing facility or indirectly through the company's immediate suppliers, indicating the facility at which the conflict minerals were processed and demonstrating that those conflict minerals did not originate in the covered countries (or that they came from recycled or scrap sources). If, based on its reasonable country-of-origin inquiry, the company

- knows that the conflict minerals did not originate in the covered countries,
- has no reason to believe that they may have originated in the covered countries, or
- concludes or reasonably believes that the conflict minerals came from recycled or scrap sources,

the company will be required to file a specialized disclosure report on new Form SD in which the company must briefly describe the reasonable country-of-origin inquiry it undertook and the results of the inquiry it performed, and provide a link to the company's public website where this information is also disclosed. These products would be considered to be "DRC conflict free," and no further disclosure or process would be required under Step Three below.

If, however, based on its reasonable country-of-origin inquiry, the company

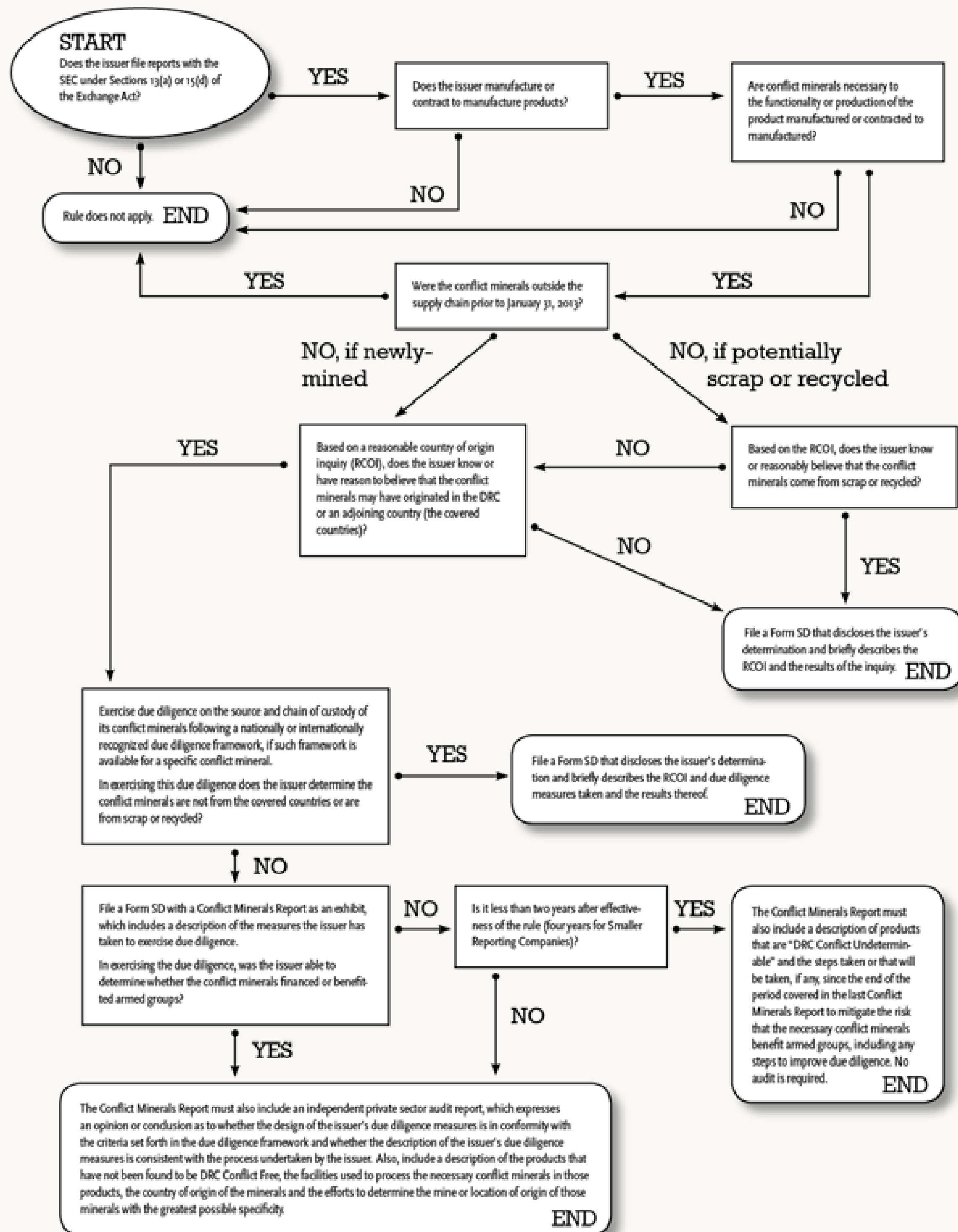
- knows or has reason to believe that any of its conflict minerals originated or may have originated in the covered countries, and
- knows or has reason to believe that they are not from recycled or scrap sources,

the company must go on to Step Three.

Step Three: In Step Three, the company must conduct substantial due diligence on the source and chain of custody of its conflict minerals, in conformance with a nationally or internationally recognized due diligence framework (if available for that mineral), to determine whether the company's minerals directly or indirectly financed or benefited armed groups in the covered countries. The SEC identified as acceptable the framework in the "Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas" (2011) developed by the Organisation for Economic Co-operation and Development (OECD), http://goo.gl/iaDui (OECD Guidance). Unless the company's due diligence shows that the conflict minerals *did not* originate in the covered countries or that they *did* come from recycled or scrap sources (as discussed further below), the company will be required to file a Conflict Minerals Report as an exhibit to a Form SD and provide a link to the company's public website where it has posted the Report. This Report must provide a description of the due diligence process, the products that have "not been found to be DRC conflict free," the processing facilities and other matters, and include a certified independent private sector audit of the Report, including an audit opinion or conclusion regarding the design of the due diligence measures and the company's description of the due diligence actually performed.

However, for a transitional period, if, after conducting due diligence, the company is unable to determine if the conflict minerals are DRC conflict free, the company must still file a Conflict Minerals Report as above, but may describe these products as "DRC conflict undeterminable" and need not include an audit of its Report, although the company must describe the steps it is taking to mitigate the risk that its minerals benefit armed groups. This temporary rule will be available for the 2013 and 2014 reporting periods (the 2013 through 2016 reporting periods for a company that qualifies as a "smaller reporting company," generally, a company with a public float of less than $75 million).

SEC flowchart summarizing the new rules



What are "conflict minerals"?

Dodd-Frank defines "conflict minerals" to include the minerals identified in the table at right (along with their derivatives, tin, tungsten and tantalum), regardless of their country of origin.

Conflict minerals would also include any other mineral or derivatives determined by the Secretary of State to be financing conflict in the covered countries, although, to date, none has been designated.

We have components and stores of materials and minerals that have been mined and stockpiled for years. Do the new rules apply to those minerals?

No. In light of concerns regarding stockpiled minerals and given that applying the rules after the fact would not further the purpose of Section 1502, the final rules exclude any conflict minerals that are "outside the supply chain" prior to January 31, 2013. Conflict minerals are considered "outside the supply chain" in the following instances:

- After any columbite-tantalite, cassiterite and wolframite minerals have been smelted;
- After gold has been fully refined; or
- After any conflict mineral, or its derivative, that has not been smelted or fully refined is located outside of the covered countries.

This transition relief should permit market participants, prior to January 31, 2013, to relocate, smelt or refine any existing stocks of conflict minerals without otherwise having to comply with the rule.

Which countries are considered to be "covered countries"?

"Covered countries" are the DRC and the countries that share an internationally recognized border with the DRC: Angola, Burundi, Central African Republic, Republic of the Congo, Rwanda, South Sudan, Tanzania, Uganda and Zambia. The U.S. State Department produced a conflict mineral map in 2011, although the rules do not require that companies rely on it. http://goo.gl/vWpMn

CONFLICT MINERAL	COMMON DERIVATIVE	COMMON APPLICATIONS
columbite-tantalite, also known as coltan	tantalum	electronic components, including mobile telephones, computers, videogame consoles, and digital cameras and as an alloy for making carbide tools and jet engine components
cassiterite	tin	electronic circuits, alloys, tin plating and solders for joining pipes
gold	—	jewelry, electronic, communications and aerospace equipment
wolframite	tungsten	metal wires, electrodes, and contacts in lighting, electronic, electrical, heating and welding applications

What does it mean to be "DRC conflict free"?

Generally, a product is "DRC conflict free" if it does not contain conflict minerals that are necessary to its functionality or production that directly or indirectly finance or benefit armed groups in the covered countries. Products are also DRC conflict free if the conflict minerals are solely from recycled or scrap sources. If products use conflict minerals that do not "directly or indirectly finance or benefit" these armed groups, the company may describe those products as "DRC conflict free," whether or not the minerals originated in the covered countries.

What is an "armed group"?

An "armed group" is defined as a group "that is identified as a perpetrator of serious human rights abuses in annual Country Reports on Human Rights Practices under sections 116(d) and 502B(b) of the Foreign Assistance Act of 1961 relating to the covered countries. (See 22 U.S.C. 2151n(d) http://goo.gl/iJKep and 22 U.S.C. 2304(b) http://goo.gl/u1NIs)

STEP ONE— Companies and products covered by the final rules

Public companies

To which companies do the new rules apply?

The final rules would apply to public companies (*i.e.*, companies that file reports under Sections 13(a) or 15(d) of the Exchange Act) that manufacture (or contract to have manufactured) products for which conflict minerals are "necessary to [their] functionality or production." There is no exemption for smaller reporting companies or for foreign private issuers, other than foreign private issuers exempt under Rule 12g3-2(b).

Manufacture or contract to manufacture

Do the final rules define "manufacture"? What does "contract to manufacture" mean?

No, the SEC believes that the term "manufacture" is widely understood. However, the release adopting the final rules clarifies that the SEC does not consider a company that only services, maintains or repairs a product containing conflict minerals to be "manufacturing" a product. Similarly, the SEC has concluded that "mining" of conflict minerals alone does not constitute manufacturing. The final rules would apply

equally to companies that manufacture products directly and to those that "contract to manufacture" their products (or components of products). The term "contract to manufacture" is not defined, but is intended to include companies if they have "some actual influence" regarding the manufacturing of those products, a change from the proposal, which would have captured companies that exercised "any" influence. More specifically, the SEC release states that an "issuer is considered to be contracting to manufacture a product depending on the degree of influence it exercises over the materials, parts, ingredients, or components to be included in any product that contains conflict minerals or their derivatives."

How do we determine whether we exercise the requisite degree of influence?

Determining the degree of influence over materials, parts, ingredients or components is necessarily a facts-and-circumstances determination. However, the SEC does provide a kind of "safe harbor": a company will not be viewed to have contracted to manufacture a product if its actions involve no more than the following:

- 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, intellectual property rights and similar terms; or
- 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.

We are a service provider that also provides cell phones. We require the manufacturer of the cell phones to make them compatible with a specified network. Would the SEC view us to exercise enough influence to have contracted to manufacture the phones?

No. However, if product specifications required inclusion of a particular conflict mineral in the product, the "influence" threshold would have been exceeded.

Our products are manufactured for us by another company, and we sell them under our private label. Would we be subject to these rules even though we don't influence or establish the manufacturing specs for the products?

Probably not. In a change from the proposed rules, the SEC concluded that private labeling of an otherwise generic product, without additional involvement by the company, would not constitute contracting to manufacture. In that case, the company is functioning as more of a sales channel than an outsourcer of manufacturing. However, if the company has involvement in the product's manufacturing beyond simply including its brand name, it would need to consider all of the facts and circumstances to assess whether it exercised the requisite degree of influence to be considered contracting to manufacture that product.

We're just retailers that sell products manufactured by others. We're not subject to these rules, are we?

No. Companies that are "pure retailers" would not be covered. More specifically, retail companies that sell only products made by third parties, including even private label products as described above, would not be subject to the rules so long as they have no other involvement in the manufacture of the products they sell.

Necessary to the functionality or production

Under the final rules, when are conflict minerals considered "necessary to the functionality" of a product?

The SEC provides no definition of when conflict minerals would be considered "necessary," but did outline several factors it believes that companies should consider in that evaluation:

- 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 (as opposed to the more subjective concepts of "basic function" or "economic utility"); or
- If a conflict mineral is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration.

Any of these factors, either individually or in the aggregate, may be outcome determinative. However, in light of the challenge of applying the provision to minerals that do not end up in the product, the SEC emphasizes that only conflict minerals contained in the product would be considered "necessary" to the functionality of that product. For products that have more than one generally expected function, a conflict mineral is necessary to the function of the product if it is necessary to any one of these functions.

What are the factors to consider in assessing whether a conflict mineral is "necessary to the production" of a product?

In evaluating whether a conflict mineral is necessary to the production of a product, which is a separate analysis from whether it is necessary to the functionality, the SEC advises companies to consider the following:

- Whether a conflict mineral is contained in the product;
- Whether it is 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.

We use gold as a catalyst in producing our products, but it is completely washed away by the time production is complete.

Would the use of gold in that manner be considered necessary to the production of our product?

No. The SEC does not consider a conflict mineral used as a catalyst or in another manner in the production process to be "necessary to the production" of the product if that conflict mineral is not contained in the product, even though, based on the facts and circumstances, the conflict mineral would have otherwise been considered "necessary to the production" of the product. However, if the mineral used as a necessary catalyst remains in the product, even in trace amounts, the mineral would be considered necessary to the production of the product.

One of our products contains a minute amount of a conflict mineral. We recall that the SEC was considering whether to adopt a *de minimis* exception for trace amounts of conflict minerals. Was that exception adopted in the final rules?

No. The SEC believes that Congress did not intend to include a *de minimis* exception. Moreover, because conflict minerals are frequently used in only trace amounts, creating a *de minimis* exception could, in the SEC's view, undermine the impact of the entire statutory scheme.

Our products are composed of metal alloys, including stainless steel, which contain tin only as a contaminant, not as part of the specification of the alloys. Would those products be subject to the final rules?

Probably not. The SEC would view the contaminant tin in the alloys as "not intentionally added" and, therefore, not "necessary to the functionality or production" of the product. The SEC believes that focusing on whether the mineral was intentionally added should address some of the concerns regarding the potentially broad reach of the final rules.

We manufacture washing machines. Would we be covered under the final rules if, although our washing machines do not contain any conflict minerals, in manufacturing our washing machines, we use machine tools and other equipment that contain conflict minerals? We would consider these tools and equipment to be "necessary" to the production of our washing machines.

No. Fortunately, the SEC views that connection as too attenuated. Even if a physical tool or machine is "necessary" to produce a product, the fact that the *tool* contains conflict minerals would not make those minerals "necessary" to the production of the *product*. Similarly, equipment only tangentially necessary to the production of a product, such as power lines and computers, would not be considered necessary to the production of a product for purposes of these rules.

Our prototype that we use for demos contains conflict minerals, but our ultimate product will not. Do we need to apply these rules to our prototype?

No. Materials, prototypes, and other demonstration devices that do not enter the stream of commerce would not be subject to the rules because they are not considered products.

If we conclude that conflict minerals are not necessary to the functionality or production of a product we manufacture or contract to manufacture, what do we need to do?

In that case, you would not be subject to the rules and nothing further would be required.

STEP TWO— Inquiry regarding origin of conflict minerals

New Form SD

What are we required to do if we determine that conflict minerals are necessary to the functionality or production of a product we manufacture?

In that case, the company must conduct a "reasonable country-of-origin inquiry" (discussed below) and file specified information about that inquiry in a specialized disclosure report on new Form SD (not in the company's Form 10-K as originally proposed). Form SD will be "filed" with the SEC, not "furnished" as originally proposed, and, therefore, will be subject to liability and private rights of action under Section 18 of the Securities Exchange Act of 1934. The disclosure in the Form SD (or its Conflict Minerals Report) must be available on the issuer's internet website for at least one year.

We understand that Form SD is required to be filed with the SEC, but will it then be incorporated by reference into our Form S-3 registration statement?

Not unless the company specifically incorporates it. Form SD is filed under Exchange Act Section 13(p) and Rule 13p-1, and the S-3 automatically incorporates only those documents and reports filed under Exchange Act Sections 13(a), 13(c), 14 and 15(d).

When will the report be due?

The new Form SD will be due by May 31 of each year for all companies required to file. Synchronizing the timing of the due date for all issuers is intended to make the process more efficient and reduce the burden through the supply chains.

What period does the Form SD cover?

Form SD covers the preceding *calendar* year.

What is the event during the relevant time period that triggers the need for the disclosure?

The triggering event for filing of a Form SD is completion, in the calendar year, of the manufacture of a product that contains necessary conflict minerals or incorporates a component product containing necessary conflict minerals. If manufacture is

completed during the calendar year, the Form SD would be required for that year. However, if the reporting company is the manufacturer of the *component product,* the component manufacturer would look to the calendar year in which it completed manufacture of the component.

When is the first report due?

The deadline for the first Form SD for all companies affected by the rules is May 31, 2014. The Form would cover the first reporting period, which is the period from January 1, 2013 to December 31, 2013.

We are in the process of acquiring a company that might use conflict minerals in its products. The company is privately held and so has not previously reported on its use of conflict minerals. Are there any exceptions for us that will allow us time to perform the necessary analysis?

Yes. The final rules permit a company that obtains control over another company that manufactures or contracts for the manufacturing of products with conflict minerals, if the acquired company previously had not been obligated to report on those minerals, to 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.

Country-of-origin inquiry

How do we determine the country of origin?

Under the final rules, a company would be required to make a "reasonable inquiry" as to whether its conflict minerals originated in the covered countries.

What does the SEC consider to be a reasonable inquiry into the country of origin?

The SEC does not provide any definition of a reasonable country-of-origin inquiry. The SEC believes that the nature of the inquiry would depend on the company's particular facts and circumstances, which might differ based on the company's size, products, relationships with suppliers or other factors and on the available infrastructure at a given point in time. However, the final rule does provide that a reasonable country-of-origin inquiry must conform to the following general standards:

- Reasonably designed to determine whether the company's conflict minerals did originate in the covered countries or did come from recycled or scrap sources; and
- Performed in good faith.

In addition, in discussing the reasonable country-of-origin inquiry, the SEC adverts to the OECD Guidance, which describes a supplier engagement approach using a range of tools. (See the June 2012 OECD interim progress report regarding downstream implementation of the OECD Guidance http://goo.gl/kqY0g for sample letters, contract provisions and other useful documents.)

Does our inquiry need to tell us the origin of our conflict minerals with absolutely certainty?

No. The SEC emphasized that a reasonable inquiry is not a prescriptive standard and does not require a company to determine "to a certainty" that all its conflict minerals did not originate in the covered countries.

We're just a small company and our products contain hundreds of components that use a lot of conflict minerals. We're feeling overwhelmed, given the large number of intermediaries and other difficulties (*e.g.,* smuggling of gold) in tracing the sources of the minerals. Can't we just disclose that and forego the inquiry?

No, the adopting release is clear that, if a company concluded that it was unreasonable to even attempt to determine the origin of its conflict minerals solely because of the large amount of conflict minerals it uses in its products or the large number of its products that include conflict minerals, that would not satisfy the rules. A reasonable inquiry is required.

Did the SEC provide any other guidance regarding the type of activities that we could perform in a reasonable inquiry?

Fortunately, yes. While insisting that there is no single or exclusive way to conduct this inquiry, the SEC has stated that one method of satisfying the reasonable inquiry standard would be to obtain reasonably reliable representations indicating the smelter or other processing facility at which the conflict minerals were processed and demonstrating that those conflict minerals did not originate in the covered countries (or that they came from recycled or scrap sources). The company must have a "reason to believe these representations are true given the facts and circumstances surrounding those representations."

How could we possibly find out what smelter was used to obtain a representation? Can't we just get a representation from our suppliers that the minerals are not from the covered countries?

To find out the smelter used, companies would need to trace the minerals by mapping the supply chain back to the smelter level, a daunting process even for many large companies. Fortunately, the SEC has indicated that these representations regarding origin could come either directly from the smelter facility or indirectly through the company's suppliers. In any case, the company would have to reasonably believe the representations were true based on the facts and circumstances.

How do we know if a representation or certification is "reasonably reliable"?

One method the SEC suggests that would allow a company to reasonably rely on a facility's representations is to have the minerals processed through a smelter or other processing facility that has received a "conflict-free" designation by a recognized industry group that requires an independent private sector audit of the smelter. Alternatively, the company could use an individual processing facility that has obtained an independent, publicly available

private sector audit of the source and chain of custody of the conflict minerals the facility processes, even though that facility may not have been designated as part of an industry group process. Clearly, companies cannot be oblivious to any applicable warning signs or other obvious defects in suppliers' representations that would lead reasonable companies to question their reliability. For example, it has been reported that one supplier represented to a company that it sourced tin ore from Japan, when Japan did not produce tin ore.

We use conflict minerals from a variety of suppliers. What do we do if we are able to obtain certifications of origin outside the covered countries from most of our suppliers, but the origin of a small amount of minerals remains unknown. Can we still characterize the minerals as "DRC conflict free"?

Yes. The company is not required to obtain representations from every single supplier, so long as the inquiry is reasonably designed and performed in good faith. In that event, if the company receives representations indicating that its conflict minerals did not originate in the covered countries, the company may reach that conclusion and characterize the minerals as "DRC conflict free," even in the absence of some certifications. The company may not, however, ignore warning signs or other circumstances that would cast doubt on that conclusion with respect to the origins of the remaining amount of its conflict minerals. Presumably, under the reasonable design and good faith criteria, the missing certifications could apply to only a limited amount of the minerals.

Is the SEC requiring that these representations be independently verified?

Not expressly. Nevertheless, although the SEC does not appear to be mandating independent verification at this point, some advocacy groups have questioned the reliability of representations in the absence of any type of independent verification of their accuracy; the SEC's suggestion above regarding representations from an audited smelter may evolve into a standard of practice that ultimately requires independent verification.

Is anything else required for the inquiry at this point?

No. However, the SEC anticipates that inquiry processes will change over time, based both on improved supply chain visibility and the results of a company's prior year inquiry. In addition, stakeholders may advocate in favor of different processes as better systems become available.

Results of the inquiry

What do the final rules require if our reasonable inquiry indicates that our conflict minerals did not originate in the covered countries?

If, based on its reasonable country-of-origin inquiry, the company concludes that its conflict minerals *did not originate* in the covered countries, or if it has *no reason to believe* that they may have originated in the covered countries (or concludes or reasonably believes that the conflict minerals came from recycled or scrap sources), the company will be required to file a Form SD including specific disclosures. With regard to those conflict minerals, however, the company would not need to perform any additional due diligence or provide a Conflict Minerals Report as required in Step Three below. While this "reason-to-believe" standard differs from the proposal in that it does not require a company to prove a negative, the imposition of this standard is designed to preclude companies from ignoring or being "willfully blind" to warning signs indicating that their conflict minerals may have originated in the covered countries.

What would be a circumstance indicating that we have "reason to believe" that our conflict minerals come from the covered countries?

The SEC indicates that one example of circumstances that, absent other information, should provide a company with reason to believe that its conflict minerals may have originated in the covered countries is if the company becomes aware that some of its conflict minerals were processed by smelters that sourced from many countries, including the covered countries, but the company is unable to determine whether the particular minerals it received from this "mixed smelter" were from the covered countries.

The SEC also points to red flags identified in the OECD Guidance (outlined below), but does not expressly endorse these red flags as necessarily requiring a conclusion that there is a "reason to believe" the minerals originated in the covered countries:

- The minerals originate from or have been transported via a conflict-affected or high-risk area (*e.g.*, an area characterized by political instability).
- The minerals are claimed to originate from a country that has limited known reserves, likely resources or expected production levels of the mineral in question (*i.e.*, the declared volumes of mineral from that country are out of keeping with its known reserves or expected production levels).
- The minerals are claimed to originate from a country in which minerals from conflict-affected and high-risk areas are known to transit.
- The company's suppliers or other known upstream companies (*i.e.*, companies in the supply chain from mines to smelter) have shareholder or other interests in companies that supply minerals from or operate in one of the above-mentioned red flag locations of mineral origin and transit.
- The company's suppliers or other known upstream companies are known to have

sourced minerals from a red flag location of mineral origin and transit in the last 12 months.

What disclosures are required in the Form SD if we determine that our conflict minerals did not originate in the covered countries or are from recycled or scrap sources?

The Form SD must indicate, under the caption "Conflict Minerals Disclosure," the company's determination and briefly describe the reasonable country-of-origin inquiry it undertook in making its determination and, to demonstrate the basis for concluding that it is not required to submit a Conflict Minerals Report, the results of the inquiry it performed. The company must make clear why it determined that its conflict minerals did not originate in the covered countries. This description is intended to enable stakeholders to assess the reasonableness of the company's efforts and potentially to advocate in favor of different processes for individual issuers if they believe it is necessary. The company must also provide a link to its website where the disclosure is publicly available. At its option, the company may describe these products in its Form SD as "DRC conflict free." The SEC also views the company's policies on the sourcing of conflict minerals to be part of the company's reasonable country-of-origin inquiry, which should be disclosed in the Form SD.

Can we add some kind of qualifying language to show that our inquiry did not result in absolute certainty regarding the source of the conflict minerals?

Yes. Companies are permitted to explicitly state that, if true, their reasonable country-of-origin inquiry "was reasonably designed to determine whether the conflict minerals did originate in the [c]overed [c]ountries or did not come from recycled or scrap sources and was performed in good faith, and the issuer's conclusion that the conflict minerals did not originate in the [c]overed [c]ountries or [that they] came from recycled or scrap sources was made at that reasonableness level."

The proposed rules would have required that we maintain supporting business records. Will that be required under the final rules?

No.

What would we be required to do if, based on our country-of-origin inquiry, we determined that the source of the conflict minerals that we use is probably located in one of the covered countries?

If the company determines, or has reason to believe, that any of its conflict minerals originated or may have originated in the covered countries (and knows or has reason to believe that they are not from recycled or scrap sources), the company must go on to Step Three. Under Step Three, the company must perform due diligence on its conflict minerals' source and chain of custody and file a Form SD disclosing, under the caption "Conflict Minerals Disclosure," that a Conflict Minerals Report is filed as an exhibit to the Form SD and including a link to its website where the Report is publicly available. The Report must include an independent private sector audit report certified by the company. (See Step Three below.)

What would we be required to do if, after our inquiry, we couldn't determine the source of the conflict minerals we use? Can we just state that there is no evidence that the conflict minerals originated in the covered countries?

No. In that event, the company must go on to Step Three.

We use a mix of conflict minerals, some of which may well originate in the covered countries and some of which we know do not. What would we be required to do?

In that case, the rules would allow you to treat the various conflict minerals separately. That is, the company would be required to go on to Step Three only for the conflict minerals that it has reason to believe originated in the covered countries, but not for those conflict minerals that it had determined did not originate in the covered countries.

STEP THREE— Conflict Minerals Report and supply chain due diligence

Conflict Minerals Report

We understand that, because we have determined that conflict minerals are necessary to our products and that they may originate in the covered countries, we will need to go to "Step Three," which requires that we conduct supply chain due diligence and prepare a Conflict Minerals Report. What do we need to include in our Conflict Minerals Report?

Under the final rules, a Conflict Minerals Report must include the following information:

- A description of the measures taken to perform due diligence on the source and chain of custody of the conflict minerals (discussed below), including the following:
  - a statement that the company has obtained an independent private sector audit of the Conflict Minerals Report, which will constitute a certification by the company of the audit; and
  - the audit report and the name of the auditor; and
- For any products that have not "been found to be DRC conflict free," the following information:
  - a description of the products;
  - the facilities (*e.g.*, the smelter or refinery) used to process the conflict minerals necessary to those products;
  - the country of origin of the conflict minerals; and

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

What do we do if we still can't determine the origin, even after we conduct due diligence?

If, even after performing the requisite due diligence, the company cannot determine that its conflict minerals are DRC conflict free (*i.e.*, that they did not directly or indirectly finance or benefit armed groups in the covered countries, or that they came from recycled or scrap sources), it will still be required to submit a Conflict Minerals Report. However, the company should be able to take advantage of a temporary transitional rule designed to allow companies time to establish supply chain due diligence tracking mechanisms (and hopefully avoid a *de facto* boycott of conflict minerals from the covered countries). This transitional rule will be available for the 2013 and 2014 reporting periods (2013 through 2016 for a company that qualifies as a "smaller reporting company").

Under the transitional rule, what information is required to be included in the Conflict Minerals Report?

In its Conflict Minerals Report, a company relying on the transitional rule would be able to describe its products as "DRC conflict undeterminable" and to omit the audit of its Conflict Minerals Report, which would otherwise be required. The company would still need to describe the due diligence undertaken, the efforts to determine the mine or location of origin with the greatest possible specificity, if applicable, as well as any steps it took or will take, after the end of the period covered in the company's most recent Conflict Minerals Report, to mitigate the risk that its conflict minerals benefit armed groups, including any steps to improve its due diligence. To the extent known after conducting due diligence, the company must describe the facilities used to process those conflict minerals and the country of origin of the conflict minerals. Similarly, if the uncertainty results instead because the company cannot determine whether its conflict minerals came from recycled or scrap sources, it will not have to describe its efforts to determine the mine or location of origin because companies with conflict minerals from recycled or scrap sources are not required to determine the mine or location of origin.

What happens if we still can't make a determination after the transition period is over?

After the transition period (*i.e.*, beginning with 2017 for smaller reporting companies and 2015 for all other companies), the company will have to describe these products in its Conflict Minerals Report as having "not been found to be 'DRC conflict free.'" An independent private sector audit will also be required.

Could we provide some explanation or qualification?

Yes. To provide guidance to readers, a company could disclose the definition of "DRC conflict free" and provide an additional explanation of its particular situation. The adopting release offers the following example of permissible additional disclosure:

> "We have been unable to determine the origins of some of our conflict minerals. Because we cannot determine the origins of the minerals, we are not able to state that products containing such minerals do not contain conflict minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country. Therefore, under the federal securities laws we must describe the products containing such minerals as having not been found to be 'DRC conflict free.' Those products are listed below."

Do we have to physically attach a label to our products describing whether or not they are DRC conflict free?

No.

How do we treat products that use a variety of conflict minerals, only some of which originate in the covered countries?

The company must treat those products as "not found to be DRC conflict free."

Can we describe our due diligence process generally?

That will depend on the facts and circumstances. If the company's process is consistent throughout its supply chain, a general description would suffice. However, if the company uses significantly different due diligence processes for different aspects of its supply chain (*e.g.*, gold and tantalum), the company should describe how they differ.

What do we do if we learn from our supply chain due diligence that our conflict minerals did not originate in the covered countries after all? Do we still need to file a Conflict Minerals Report?

No. If, as a result of that due diligence, the company determines that its conflict minerals did not originate in the covered countries (or that they did come from recycled or scrap sources), no Conflict Minerals Report is required. However, the company must still file a Form SD disclosing its determination and briefly describing its due diligence and, to demonstrate support for its conclusion, the results of the due diligence and including a link to its website where this information is publicly available.

We are aware that the Extractives Working Group of the Electronics Industry Citizenship Coalition/Global e-Sustainability Initiative (EICC-GeSI) has a Conflict-Free Smelter Program under which it is identifying and validating "compliant smelters" that process minerals from the covered countries but satisfy its protocols, which include the OECD Guidance. If we source our minerals from a "compliant smelter," do we still need to file a Conflict Minerals Report and incur the expense of an audit?

Yes. In recent conversations, a member of the SEC staff informally advised us that

sourcing from CFS-validated "compliant smelters" that source from the covered countries *does not* eliminate the need to prepare and file a Conflict Minerals Report, including an independent private sector audit. The staff member did indicate, however, that the staff may give further consideration to the issue.

You noted above that control over the mines by armed groups shifts back and forth. If the mine that is the source of our minerals subsequently comes under control of an armed group after the minerals were purchased, do the minerals lose their status as DRC conflict free?

No. As long as the minerals did not directly or indirectly finance or benefit armed groups when they were purchased and transported through the supply chain, they are considered "DRC conflict free" even if, at some point in that supply chain, the mine subsequently comes under the control of an armed group and even if the armed group uses the money previously paid to the miner for the minerals.

Independent private sector audit

What kind of audit is required in the Report?

The company must include in the Conflict Minerals Report an independent private sector audit of the Report, conducted in accordance with standards established by the U.S. Comptroller General. According to the SEC staff, the GAO believes that no new standards are required to be promulgated, but rather that auditing standards that are part of the Government Auditing Standards, commonly referred to as the "Yellow Book," such as the standards for Attestation Engagements or the standards for Performance Audits, will be applicable. (See Government Auditing Standards 2011 Revision (Dec. 2011), available at http://goo.gl/4mXss.) The company would be required to certify that it obtained the independent private sector audit by stating in the Report that it obtained the audit. The certification need not be signed by an officer of the company. The certified audit is considered "a critical component of due diligence in establishing the source and chain of custody of such minerals." We expect that third-party providers with the capability to perform these audits, which may include registered public accounting firms, will emerge over time.

Are there any special independence requirements for this audit?

No, the SEC did not impose any additional independence requirements, and the entity performing the audit of the Conflict Minerals Report must otherwise comply with any independence standards established by the GAO.

If the firm that audits our financial statements also performed the audit of our Conflict Minerals Report, would they still be considered independent?

The SEC indicated that it does not believe that performance of the audit of the Conflict Minerals Report would taint the auditor's independence under Rule 2-01 of Regulation S-X; however, the engagement to perform the audit would be considered a "non-audit service" subject to the pre-approval requirements of Rule 2-01(c)(7) of Regulation S-X, and the related fees would need to be included in the "All Other Fees" category of the principal accountant fee disclosures in the proxy statement.

What is the objective of the audit? Must the audit include a report that reaches a conclusion regarding the objective?

Yes. The final rules provide that the audit's objective is to express an opinion or conclusion regarding the following:

- Whether the design of the due diligence framework as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is in conformity with, in all material respects, the criteria set forth in the nationally or internationally recognized due diligence framework used by the company, and
- Whether the description of the due diligence measures it performed as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is consistent with the due diligence process that the company undertook.

Accordingly, the audit need not cover the entire Conflict Minerals Report, but may be limited to the sections of the Conflict Minerals Report that discuss the design of the company's due diligence framework and the due diligence measures the company performed.

Does the audit report need to conclude that the measures we took were effective or that our products are DRC conflict free?

No.

Due diligence

What kind of due diligence do we need to perform for purposes of the Conflict Minerals Report? Is that due diligence the same as the inquiry we performed to try to determine the country of origin?

No. As discussed below, the due diligence on the source and chain of custody that the rules require as part of Step Three must follow a nationally or internationally recognized due diligence framework and is quite substantial, requiring a more exhaustive investigation than the reasonable inquiry into the country of origin that is required under Step Two. The objective of this due diligence investigation is to determine whether the company's conflict minerals directly or indirectly financed or benefited armed groups in the covered countries.

The proposal didn't require use of a nationally or internationally recognized

framework. Why the change in the final rules?

The SEC was convinced by commentators that requiring the use of a nationally or internationally recognized due diligence framework would provide a consistent structure that would facilitate the private sector audit, making the rule more workable and less costly. In addition, the SEC expects that use of a framework will enhance the quality of due diligence, promote comparability of the Conflict Minerals Reports among companies and provide companies with a degree of comfort that their processes will not be second-guessed.

Can you provide examples of an appropriate framework?

Yes, the SEC identifies the framework contained in the OECD Guidance as a framework that satisfies its criteria. The OECD Guidance also includes special due diligence supplements for gold http://goo.gl/ZIHMk and for the three T's http://goo.gl/iaDui. Notably, the U.S. State Department also specifically endorses the OECD framework. http://goo.gl/rvMUH

Are we required to use the framework in the OECD Guidance?

No. The SEC recognizes that other evaluation standards may develop over time. However, to satisfy the final rules, the framework must have been established by a group that has followed due process, including the broad distribution of the framework for public comment, and it must be consistent with the criteria in the Government Auditing Standards established by the GAO. Currently, the OECD framework is the only one to satisfy all of those criteria.

What does the OECD Guidance require?

The guidance for the three T's suggests five steps:

- Establish strong company management systems
  - adopt a supply chain policy
  - structure internal management systems to support due diligence
  - establish, independently or through industry-driven programs, a system of controls and transparency over the mineral supply chain (including a chain of custody or a traceability system that allows the identification of upstream actors, such as smelters and refiners, in the supply chain through which information can be obtained about "red flags")
  - strengthen engagement with suppliers (*e.g.*, through contractual provisions and correspondence)
  - establish a company-level grievance mechanism
- Identify and assess risk in the supply chain
  - using best efforts, identify the smelters/refiners in the supply chain
  - identify the scope of the risk assessment of the mineral supply chain
  - assess whether the smelters/refiners have carried out all elements of due diligence for responsible supply chains of minerals from conflict-affected and high-risk areas
  - where necessary, carry out, including through participation in industry-driven programs, joint spot checks at the mineral smelter/refiner's own facilities
- Design and implement a strategy to respond to identified risks
  - report findings to designated senior management
  - devise and adopt a risk management plan
  - implement the risk management plan, monitor and track performance of risk mitigation, report back to designated senior management and consider suspending or discontinuing engagement with a supplier after failed attempts at mitigation
  - undertake additional fact and risk assessments for risks requiring mitigation, or after a change of circumstances
- Carry out independent third-party audit of supply chain due diligence at identified points in the supply chain
  - plan an independent third-party audit of the smelter/refiner's due diligence for responsible supply chains of minerals from conflict-affected and high-risk areas
  - implement the audit in accordance with the audit scope, criteria, principles and activities set out above
- Report annually on supply chain due diligence

Can we rely on certifications from suppliers or smelters?

Representations may be relied on only to the extent that reliance on certifications is permitted under the nationally or internationally recognized due diligence framework.

Have any advocacy or other organizations developed any useful materials?

Yes. In June 2012, the OECD issued an interim progress report regarding downstream implementation of the OECD Guidance http://goo.gl/kqY0g. This additional guidance describes the practices that participating companies have undertaken and includes sample company policies, contract provisions, questionnaires, letters to suppliers and letters to customers regarding the use of conflict minerals. Collaborative industry organizations and trade associations, sometimes in conjunction with third parties, have also been developing processes to trace and audit supply chains for conflict minerals.

What are industry organizations and trade groups doing?

Some organizations have, either independently or working with third parties, been working to develop processes to trace and audit supply chains and have otherwise sought to use their collective leverage to gain assurances about the sources of supply. For example, as noted above, the EICC-GeSI, a group of technology companies, developed the "Conflict-Free Smelter Program," a validation process designed to enable responsible sourcing from the covered countries. The program involves auditing supply chains and identifying those smelters or other processing facilities that can demonstrate, under CFS protocols, that they source only minerals that are "DRC conflict free." CFS protocols entail meeting the requirements of the OECD Guidance and validation by third parties. Smelters have been characterized as key to sourcing because they represent a "crucial chokepoint in the supply chain" where minerals are processed into metals. In May 2012, EICC-GeSI announced the first tin and first tantalum smelters processing materials from the DRC that had been found compliant with the CFS protocols and, in June 2012, the group announced the first three gold refiners that had been found compliant with the CFS protocols. Additional smelters and refiners processing tantalum, tin, tungsten and gold are scheduled to be audited using the CFS Program protocols in the future. EICC has also developed a reporting template and dashboard that companies may use for obtaining information from their suppliers about material content, smelters used and/or country of origin. http://goo.gl/Am6h5 IPC, an Association Connecting Electronics Industries, also offers a number of resources http://goo.gl/248qX.

Similarly, a tin industry trade group, the International Tin Research Institute (ITRI) http://goo.gl/bvWKt, has commenced a Tin Supply Chain Initiative, a joint industry program of traceability and due diligence designed to assist upstream companies in instituting the actions, structures and processes necessary to conform with the OECD Guidance for minerals, such as cassiterite, from the DRC. Based on the belief that smelters and mines are best positioned to develop chain-of-custody data regarding conflict minerals, ITRI has sought to track shipments of ore from the source of origin, at the mine and smelter level, using a "bag-and-tag" tracking system that attaches a tag and bar code to each shipment starting at the mine of origin. The Automotive Industry Action Group (AIAG) has developed a web-based tool to track both materials and smelter used. Similarly, the World Gold Council http://goo.gl/83jCL has developed a conflict-free gold standard. Also, the Responsible Jewellery Council is developing a system to certify members for ethical practices in the gold jewelry supply chain and has participated in the OECD-hosted working group for responsible supply chain management of minerals from conflict-affected and high-risk areas. We expect that collaborative initiatives may develop through other trade associations, and these collaborations should be especially beneficial in helping small- and medium-sized manufacturers comply with the rules.

Have individual companies really been able to perform their own due diligence?

Yes, some companies have performed due diligence regarding conflict minerals that involve full-scale investigations of their supply chains, including identifying the relevant mineral smelters and conducting on-site inspections of facilities and smelters. However, a process of this type may be overwhelming for smaller companies without the resources to conduct these types of investigations. We expect that, in most cases, smaller companies will look to trade associations or independent third parties to perform these activities on their behalf.

Recycled and scrap sources

Our products use conflict minerals from recycled and scrap sources rather than from mined sources. We can't imagine how we could possibly examine the recycling or scrap process to determine the origin of the minerals. Is there any exception for us?

Yes. To avoid creating a disincentive for the use of conflict minerals from recycled and scrap sources and because armed groups are not likely to benefit from transactions involving recycled or scrap minerals, the SEC is providing an alternative treatment for those minerals. Under the final rules, the company must conduct an inquiry, similar to a reasonable country-of-origin inquiry, to determine whether its minerals are from recycled or scrap sources. If, as a result of that inquiry, the company has reason to believe that its conflict minerals *may not have been from recycled or scrap sources,* it must then perform due diligence and, unless it determines as result of the due diligence that the minerals did come from recycled or scrap sources, provide a Conflict Minerals Report. Products that are solely from recycled or scrap sources are considered "DRC conflict free."

When is a conflict mineral considered to be "recycled"?

The final rules, which are based on the OECD definition, consider conflict minerals to be from recycled or scrap sources "if they are from recycled metals, which are reclaimed end-user or post-consumer products, or scrap processed metals created during product manufacturing. Recycled metal includes excess, obsolete, defective, and scrap metal materials that contain refined or processed metals that are appropriate to recycle in the production of tin, tantalum, tungsten and/or gold. Minerals partially processed, unprocessed, or a bi-product from another ore will not be included in the definition of recycled metal."

We initially thought that our minerals were recycled, but following our reasonable inquiry, we had second thoughts, that is, we had "reason to believe" that the minerals may not be recycled. What kind of diligence is required for scrap or recycled conflict minerals?

In that event, as with newly mined minerals, the company must perform due diligence that conforms to a nationally or internationally recognized due diligence framework, if such a framework is available. However, the SEC acknowledges that the OECD's supplement for gold http://goo.gl/ZIHMk is the only nationally or internationally recognized due diligence framework for any conflict mineral from recycled or scrap sources. Until one is developed for the other conflict minerals, companies will not be required to follow a recognized framework for conducting due diligence regarding scrap or recycled sources for those minerals. If one becomes available prior to June 30 of a calendar year, the first reporting period in which issuers must use the framework for that conflict mineral will be the subsequent calendar year.

Compliance

Who will be monitoring compliance?

We can expect that, in addition to the SEC, advocacy groups will continue to monitor the levels of compliance and alert the SEC regarding companies whose efforts they question. The Enough Project has already indicated that two of the major compliance concerns that it expects to monitor closely are whether companies that should file Forms SD actually do so and whether each company's reasonable country of origin inquiry "produces a conclusive result. Due diligence is only triggered when a company knows or has reason to believe its minerals came from Congo or neighboring countries. Companies may perceive an incentive to conduct a country of origin inquiry that produces inconclusive results, believing they would not have to conduct due diligence in such a case. Advocates will need to monitor good faith compliance in the conduct of these inquiries."

If you have any questions about this *Alert*, please contact one of your Cooley team members or one of the attorneys identified above.