

Summary of Conflict Minerals Rule

Overview

Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) addressed concerns that proceeds from the trade and exploitation of certain minerals originating in several central African countries were helping to finance extraordinary violence in the Democratic Republic of the Congo (the “DRC”). Congress hoped that these rules would help bring an end to that violence. Section 1502 of the Dodd-Frank Act added Section 13(p) to the Securities Exchange Act of 1934 (the “Exchange Act”) and required the Securities and Exchange Commission (“SEC” or “Commission”) to promulgate new disclosure and reporting requirements concerning the use of these minerals.

On August 22, 2012, the SEC issued the long-awaited final rule relating to conflict minerals (the “Rule”). The Rule was promulgated as new Rule 13p-1 under the Exchange Act and includes reporting requirements on the new Form SD.

This memorandum summarizes the Rule and the guidance provided in the release relating to it (the “Release”). The Rule and the SEC Release are available at <http://www.sec.gov/rules/final/2012/34-67716.pdf>. The Release includes a [flowchart](#) the SEC suggests as a guide to compliance with the Conflict Minerals Rule.

The Conflict Minerals Rule

The Rule requires any reporting company having conflict minerals that are necessary to the functionality or production of a product manufactured or contracted to be manufactured by that reporting company to file a report with the SEC on Form SD, disclosing whether those conflict minerals originated in a Covered Country (defined below) and whether those conflict minerals benefit or finance armed groups in the Covered countries. The reports must also be posted on the reporting company’s website for one year.

It is important to note that the Rule does not prohibit the use of conflict minerals in products. Instead, the Rule requires public disclosure of how the conflict minerals are used by the reporting company. Customer requirements and shareholders’ and the public’s reactions to the reporting company’s disclosures could influence the reporting company’s actions and policies with respect to conflict minerals.

Note, it is not only reporting companies that should be concerned about the Rule. Nonreporting companies may be asked by their customers to provide information about conflict minerals in their products. To provide that information, the nonreporting company suppliers will need to perform their own diligence, even if they are not required to file disclosure reports with the SEC.

Key Terms

“Conflict minerals” are **tantalum** (derived from columbite-tantalite), **tin** (derived from cassiterite), **tungsten** (derived from wolframite), **gold** or any other minerals or derivatives thereof that the US Secretary of State may in the future conclude are financing conflict in the Covered countries (defined below).

The following are common uses of these minerals/ores:

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

Due to the many uses of these conflict minerals, the Rule applies to thousands of reporting companies and hundreds of thousands of suppliers.

“Covered countries” are the Democratic Republic of the Congo, Zambia, Angola, Republic of the Congo (Brazzaville), Central African Republic, South Sudan, Uganda, Rwanda, Burundi and Tanzania.

A “reporting company” is any entity that files reports with the SEC under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (i.e., Forms 10-Q, 10-K, 20-F and 8-K). There is no exception from the Rule for foreign private issuers, emerging growth companies or smaller reporting companies.

Conflict minerals are considered to be “outside the supply chain”:

- If they have been smelted (in the case of tantalum, tin or tungsten) or fully refined (in the case of gold) before January 31, 2013, or
- If they have not been smelted or fully refined, if they are physically located outside of the Covered countries before January 31, 2013.

Conflict minerals that are outside the supply chain before January 31, 2013 are excluded from reporting requirements.

Products are considered “DRC conflict free” if they “do not contain minerals that directly or indirectly finance or benefit armed groups in the Covered countries.”

Filing/Reporting

Disclosures that are required by the Rule are to be made by reporting companies on new Form SD (“specialized disclosure”), which is due for every reporting company on a calendar year basis (regardless of the company’s fiscal year). The Form SD must be filed with the SEC by May 31 of the following year. The first reports are due on May 31, 2014.

The Rule provides that Form SD is to be filed, not furnished. Reporting companies will, therefore, be subject to liability under Section 18 of the Exchange Act for any false or misleading statements in their Form SD. Section 18 liability is subject to a defense that the reporting company acted in good faith and did not have knowledge that the report made was false and misleading. The Form SD need not be accompanied by the officer certifications by the CEO/CFO that are required with other periodic reports and is not incorporated into the reporting company’s registration statements under the Securities Act of 1933, unless the reporting company specifically incorporates them.

Recycled/Scrap Sources

To address concerns about the difficulty in applying the disclosure requirements to recycled and scrap materials, the Rule provides that products containing conflict minerals originating from recycled or scrap sources do not automatically trigger an obligation to file a Conflict Minerals Report. Rather, products containing such materials are considered “DRC Conflict Free” and require disclosure only about the inquiry that led the reporting company to conclude that the conflict minerals were from recycled or scrap sources.

The SEC adopted a definition of “recycled or scrap” that is consistent with the definition used by the Organisation for Economic Co-operation and Development (OECD) for recycled metals. The OECD defines “recycled metals” as reclaimed end-user or post-consumer products, or scrap processed metals created during product manufacturing. The definition includes excess, obsolete, defective and scrap metal materials that contain refined or processed metals. However, minerals that are partially processed or unprocessed, or that are a byproduct from another ore, are not included in the definition of “recycled metals” and disclosure and reporting about them is required.

3-Step Analysis Required by the Rule

The Rule requires reporting companies to undertake a 3-step analysis of the use and origin of the conflict minerals.

- Step One – Does the Rule apply to us?
- Step Two – Do our conflict minerals come from the covered countries?
- Step Three – Do our conflict minerals benefit or finance armed groups in the covered countries?

Step One: Does the Rule Apply to Us?

A reporting company must make a good faith determination as to whether the Rule applies to it. The Rule applies to:

- A reporting company
- that has conflict minerals that are necessary to the functionality or production of a product manufactured or contracted to be manufactured by it.

If the reporting company does not meet both elements of this test, it is not required to take any further action, make any disclosures or submit any reports, and its diligence inquiry for purposes of compliance with the Rule are at an end.

What Does it Mean to “Manufacture” a Product?

If a reporting company does not “manufacture” or “contract to manufacture” a product, the Rule does not apply and the reporting company has no further obligations under the Rule. Because the term is not defined, it is unclear how the SEC will interpret it. Thus, reporting companies should consider carefully when determining that they do not “manufacture” a product.

The SEC has chosen not to define the term “manufacture” because it believes the term is generally understood. But, the SEC has provided guidance regarding the meaning of the term. According to the Release, manufacturing does include the assembly of a product out of materials, substances or components manufactured by others.

The Rule specifically exempts reporting companies that merely mine conflict minerals and reporting companies that merely contract to mine conflict minerals.

What Does it Mean to "Contract to Manufacture" a Product?

The Rule does not define "contract to manufacture." However, in the Release, the SEC's guidance indicates that a reporting company "contracts to manufacture" a product when it has some actual influence over the manufacturing of that product. The reporting company should determine whether it "contracts to manufacture" by considering the relevant facts and circumstances and taking into account the influence exercised by it over the materials, parts, ingredients or components to be included in the product. The Release clarifies that the SEC will not deem a reporting company to be "contracting to manufacture a product" if the reporting company only:

- Specifies or negotiates contractual terms with a manufacturer that do not directly relate to the manufacturing of the product unless such contractual terms are negotiated to such a degree the reporting company practically exercised influence directly relating to the manufacturing of the product,
- Affixes its brand, marks, logo or label to a generic product manufactured by a third party, or
- Services, maintains or repairs a product manufactured by a third party.

What is a "Product"?

If a reporting company does not manufacture, or contract to manufacture, a "product," the Rule does not apply and the reporting company has no further obligations under the Rule. The SEC has chosen not to define the term "product," presumably because it believes the concept to be intuitive. Further, the SEC does not even provide any guidance relating to the term "product." The term "product" certainly applies to a good and not a service. And, unless the packaging is important to the function of the product, a "product" would not include the packaging. For instance, for a component that is delivered to a customer in a box, the product is the component and not the box. But, other kinds of packaging lead to more difficult analysis.

One test that might be used to identify a company's product is to consider the source of the company's revenue. If a company is making money from sales of an item, then that item will likely be considered a "product" under the Rule. This test may be too expansive, however. An alternative test that may be used is to consider the content or the item of value, and not the packaging or medium used to deliver the content. Under the content test, even though the medium or package used to deliver the product contains conflict minerals, the content itself is conflict mineral free and therefore the Rule does not apply. This test may be helpful to service-oriented companies as they analyze whether they sell a product.

Because "product" is not defined and there is no guidance as to its meaning, it is unclear how the SEC will interpret it. Therefore, reporting companies should consider carefully when determining that they do not manufacture a "product." Reporting companies should watch for future SEC guidance as to how to define a "product."

What Does it Mean to be "Necessary to the Functionality" of a Product?

If the conflict minerals contained in the product are not "necessary to the functionality" of the product, the Rule does not apply and the reporting company has no further obligations under the Rule with respect to that product. The Rule does not define when a conflict mineral is "necessary to the functionality" of a product. Whether a conflict mineral is deemed "necessary to the functionality" of a product depends on the reporting company's particular facts and circumstances.

Only a conflict mineral that is contained in the product is "necessary to the functionality" of that product.

In determining whether its conflict minerals are “necessary to the functionality” of a product, a reporting company 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,
- If a conflict mineral is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration, and
- Any conflict mineral is contained in its product and intentionally added in the production process of the product or in the production process of any component of the product.

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

A conflict mineral is “necessary” to the product whether it was added by the reporting company or added to a component of the product that the reporting company receives from a third party.

To be “necessary” to the product, the conflict mineral need not be limited to the product’s “basic function” or “economic utility.” When there are multiple functions and uses, the conflict mineral need only be necessary for one function to be “necessary to the functionality” of that product. Even if the conflict mineral is purely ornamental, that may not be sufficient to exclude product from the rule if the product itself is primarily ornamental.

If any conflict mineral is present in a finished product, the reporting company will need to proceed to Step Two of the process unless it can demonstrate that the conflict mineral in the finished product was not necessary to the production or functionality of the product, which is likely to be difficult.

Reporting companies that contract for the manufacture of products, such as retailers with respect to private label goods, would not be covered by the Rule if they do not specify terms to the degree that they are influencing the manufacture of those products.

What Does it Mean to be “Necessary to the Production” of a Product?

If the conflict minerals contained in the product are not “necessary to the production” of the product, the Rule does not apply and the reporting company has no further obligations under the Rule with respect to that product. The Rule does not define when a conflict mineral is “necessary to the production” of a product. Whether a conflict mineral is deemed “necessary to the production” of a product depends on the reporting companies’ particular facts and circumstances.

To be “necessary to the production” of a product, the conflict mineral must be contained in the product and intentionally added in the production process of the product.

The Release provides guidance relating to the criteria to consider when assessing whether a conflict mineral is “necessary to the production” of a product, advising reporting companies to consider:

- Whether the conflict mineral is intentionally included in the product’s production process, other than if it is included in a tool, machine or equipment used to produce the product (such as computers or power lines),
- Whether the conflict mineral is included in the product, and
- Whether the conflict mineral is necessary to produce the product. In the Release, the SEC states that the conflict mineral must be both contained in the product and necessary to the product’s production in order to be “necessary to the production” of that product.

In order to be deemed necessary to production, a conflict mineral must appear in the final product.

Therefore, a reporting company that only uses tools made of conflict minerals to produce a device will not fall within the disclosure requirements of the Rule unless it appears in the final product.

If a conflict mineral is used as a catalyst as part of production and appears in the final product, then the conflict mineral is necessary to production and the reporting company is subject to the Rule.

The SEC further noted that if a conflict mineral is necessary to the functionality or production of a product, then the product is covered by the Rule even if only a de minimis amount of conflict minerals is contained in the final product.

Step Two: Do Our Conflict Minerals Come From Covered Countries?

If conflict minerals are necessary to the functionality or production of a product manufactured by a reporting company, the Rule requires the reporting company to disclose on a new Form SD whether those conflict minerals originated in the covered countries. In order to make such disclosure, the reporting company must make a reasonable country of origin inquiry.

Reasonable Country of Origin Inquiry

The inquiry must cover all of the conflict minerals that are necessary to the functionality or production of the products which it manufactures or contracts to be manufactured. The Release does not set forth the specifics of what constitutes a “reasonable country of origin inquiry.” Under the Rule, the reporting company’s reasonable country of origin inquiry must be:

- Conducted in good faith, and
- Reasonably designed to determine whether the reporting company’s conflict minerals originated in the covered countries or are from recycled or scrap resources.

The SEC indicates that the reasonable country of origin inquiry depends on the reporting company’s particular facts and circumstances, including factors such as the reporting company’s size, products and relationship with suppliers, as well as other factors. A reporting company will be viewed as satisfying the reasonable country of origin inquiry if it obtains reasonably reliable representations identifying the facility at which its 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 reporting company is not required to receive representations from all of its suppliers, so long as its inquiry is reasonably designed and conducted in good faith.

For example, if a processing facility received a “conflict free” designation from certain recognized industry groups or if the facility itself obtained and made publicly available a private sector audit certifying it as “conflict free,” then the reporting company has reason to believe the representations are true. The reporting company must have reason to believe that these representations are true and must take into account any warning signs or other circumstances indicating that the conflict minerals it uses may have originated in the covered countries or did not come from recycled or scrap sources.

When Are Reporting Companies Not Required to Undertake Further Due Diligence?

The reporting company is not required to exercise further due diligence on its conflict minerals’ sources or chain of custody or file the Conflict Minerals Report described below if, after completing its reasonable country of origin inquiry, the reporting company:

- Determines that the conflict minerals it uses did not originate in the covered countries or came from recycled or scrap sources, or
- Has no reason to believe that the conflict minerals it uses originated in the covered countries or

reasonably believes that the conflict minerals it uses are from recycled or scrap resources.

If no further due diligence is required, the reporting company must:

- File a Form SD disclosing its determination regarding the conflict minerals summarizing the reasonable country of origin inquiry it conducted and the results of that inquiry,
- Publicly disclose this information on its website (and it must retain the information on the website for one year), and
- Provide a link to its website on the Form SD.

“DRC Conflict Undeterminable”

For calendar years 2013 and 2014 (and for calendar years 2013 – 2016 for a “smaller reporting company”), a reporting company that performs its reasonable country of origin inquiry but is unable to determine whether its conflict minerals are from the covered countries and whether they benefit or finance armed groups is permitted to conclude that its products are “DRC conflict undeterminable.”

For products that are “DRC conflict undeterminable,” the reporting company must disclose certain information in its Conflict Minerals Report. For products that are “DRC conflict undeterminable,” an independent private sector audit of the Conflicts Minerals Report is not required as to those products.

During the limited transition period, if a reporting company concludes that its products are “DRC conflict undeterminable,” then it must report the following in its Conflict Minerals Report:

- A description of the actions taken to exercise due diligence on the source and chain of custody of the reporting company’s conflict minerals,
- The steps the reporting company has taken or will take, if any, since the end of the period covered in its most recent prior Conflict Minerals Report to mitigate the risk that its necessary conflict minerals benefit armed groups, including any steps to improve its due diligence,
- The country of origin of the conflict minerals, if known,
- The facilities used to process the conflict minerals, if known, and
- The efforts the reporting company has made to determine the mine or location of origin of the conflict minerals with the greatest possible specificity, if applicable.

The transition period will not, however, be available to any company that knows that its conflict minerals financed or benefitted armed groups in the covered countries. Companies relying on the transition period must make the same disclosures that would apply if the conflict minerals were found not to be “DRC Conflict Free” and must also describe the steps that the company has taken or will take, if any, since the end of the year covered by the Conflict Minerals Report to mitigate the risk that its conflict minerals will benefit armed groups.

Step Three: Do Our Conflict Minerals Benefit or Finance Armed Groups in the Covered Countries?

If, after completing its reasonable country of origin inquiry, the reporting company:

- Determines that the conflict minerals it uses originated in the covered countries or came from recycled or scrap sources, or
- Has reason to believe that its conflict minerals originated in the covered countries or are not from recycled or scrap sources; or
- After the temporary period, cannot determine the source of its conflict minerals,

then the reporting company must exercise further due diligence on the source or chain of custody of its conflict minerals.

If it has to undertake this additional due diligence, it will be required to file a Conflict Minerals Report as an exhibit to its Form SD, post its Conflict Minerals Report on its public website (and keep it there for one year), and provide a link to its website on the Form SD. The Conflict Minerals Report must reflect the reporting company's conclusions, based on its due diligence, as to whether its products are "DRC conflict free" or "not DRC conflict free." The Conflict Minerals Report must be audited as described below.

"DRC conflict free" is defined as not containing conflict minerals that directly or indirectly finance or benefit armed groups in the covered countries.

If after exercising due diligence measures on the source and chain of custody of the conflict minerals, the reporting company concludes that the conflict minerals it uses did not in fact originate in the covered countries or did come from recycled or scrap sources, then the reporting company is not required to complete and file a Conflict Minerals Report with its Form SD. Instead, it must disclose its reasonable country of origin inquiry, due diligence efforts and the results of the inquiry and due diligence efforts on a Form SD. The reporting company also must disclose this information on its public website and provide a link to this website on the Form SD.

Due Diligence Framework

Reporting companies required to exercise due diligence measures on the source and chain of custody of their conflict minerals must use due diligence measures that conform to a nationally or internationally recognized due diligence framework, if one exists, such as the guidance approved by the Organisation for Economic Cooperation and Development (OECD), available at <http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/46740847.pdf>.

Conflict Minerals Report

The Conflict Minerals Report must include:

- A description of the due diligence measures that the reporting company undertook to determine the source and chain of custody of its conflict minerals, or diligence measures that the reporting company undertook in determining that the conflict minerals came from recycled or scrap sources,
- A certification by the reporting company that it obtained such an independent private sector audit,
- A description of the reporting company's products that have not been found to be "DRC conflict free," the facilities used to process the conflict minerals in those products, the country of origin of those conflict minerals, and the efforts made to determine the mine or location of origin with the greatest possible specificity,
- For any products that are "DRC conflict undeterminable," the steps it has taken or will take, if any, since the end of the period covered in its most recent prior Conflict Minerals Report to mitigate the risk that its necessary conflict minerals benefit armed groups, including any steps to improve its due diligence; the country of origin of the conflict minerals, if known; the facilities used to process the conflict minerals, if known; and the efforts to determine the mine or location of origin with the greatest possible specificity, if applicable (provided that the reporting company is not required to obtain a private sector audit of the Conflict Minerals Report relating to products that are "DRC conflict undeterminable"), and
- The audit report prepared by the independent private sector auditor, which would identify the entity that conducted the audit.

Private Sector Audit

In most circumstances, the reporting company also is required to obtain an independent private sector audit of the reporting company's Conflict Minerals Report. The objectives of the independent private sector audit are to express an opinion as to whether:

- The design of the due diligence measures conforms to a nationally or internationally recognized due diligence framework, and
- The due diligence measures described in the Conflict Minerals Report were actually performed in the period covered by the report.

The audit is not required to state any opinion as to the conclusions reached by the reporting company.