

SEC Proposed Rules for Disclosure Concerning Conflict Minerals Originating in the Democratic Republic of the Congo and Adjoining Countries

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Client Advisory

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The SEC has proposed rules to implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. These rules require U.S. companies and foreign private issuers that are reporting under the Securities Exchange Act of 1934 to provide disclosures about conflict minerals that are “necessary to the functionality or production of a product manufactured or contracted to be manufactured by the company.”

Conflict minerals are: cassiterite (used in tin), columbite-tantalite (the metal from which tantalum is extracted), gold, wolframite (used to produce tungsten), or their derivatives, or any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country (called “DRC countries”). These minerals are used in many products, including computers, mobile telephones and other consumer electronics, jewelry and electronic, communication and aerospace equipment.

The proposed rules would require companies that file Exchange Act reports with the SEC to undertake a three-step analysis to determine whether disclosure is required and if so, what they are required to disclose about their use of conflict materials. The inquiry would be as follows:

Step 1: Are conflict minerals necessary to the functionality or production of a product manufactured or contracted to be manufactured by the company?

Companies that do not meet this criteria would not be subject to the rules. If any conflict minerals are necessary to the functionality or production of a product that a company manufactures or contracts to manufacture, then the company must move to step 2 of the analysis. Step 2 requires the company to inquire into the country of origin of the conflict minerals and make certain disclosures about the conflict minerals.

Although not expressly defined in the proposed rules, a conflict mineral would be considered “necessary to the functionality or production of a product” if the conflict mineral is intentionally included in a product’s production process and necessary to that process, even if the conflict mineral is ultimately not included in the final product.

The proposed rules do not define what it means to “manufacture” or “contract to manufacture” a product containing conflict minerals, but this would include companies that:

- a. have influence over the manufacturing of products containing conflict minerals;

- b. sell generic products containing conflict minerals under their own brand name or a separate brand name that they have established (regardless of whether the companies have any influence over the manufacturing specifications of the product, as long as the companies have contracted with another party to have the product manufactured specifically for those companies); or
- c. mine or contract to mine conflict minerals.

The proposed rules would not apply to retailers that (a) sell only products of third parties if those retailers have no contract or other involvement in the manufacturing of those products, or (b) do not sell those products under their brand name or a separate brand they have established and do not have those products manufactured specifically for them.

Step 2: Make a Reasonable Inquiry into Whether Necessary Conflict Minerals Originated in DRC Countries.

If a company determines that conflict minerals are necessary to the functionality or production of a product manufactured or contracted to be manufactured by the company, it would then be required to make a reasonable inquiry into the country of origin of the conflict minerals. A reasonable inquiry into the country of origin does not require companies to decide with absolute certainty the origin of their conflict minerals. The proposed rules do not define the steps necessary to constitute a reasonable inquiry; although the release does say that a company might be able to meet this standard by receiving reasonably reliable representations about the origin of the conflict minerals from the facility where the conflict minerals were processed.

If the company concludes that some or all of its conflict minerals did not originate in a DRC country, the company would disclose in its annual report filed with the SEC both that conclusion and a description of the reasonable inquiry into the country of origin that it conducted concerning those minerals. The company would also be required to post this disclosure on its website, disclose the address of that website in its annual report, retain the disclosure on its website at least until the company files its next annual report with the SEC and maintain reasonable business records to support the determination.

Step 3: Perform Due Diligence on the Source and Chain of Custody and Furnish a Conflict Mineral Report with an Independent Audit Report

After a reasonable country of origin inquiry, if a company determines that: (a) its necessary conflict minerals originated in DRC countries, (b) it is unable to determine that its minerals did not originate in a DRC country or (c) its conflict minerals come from recycled or scrap sources, it would be required to disclose its conclusion (or inability to reach a conclusion) about the origin of its conflict minerals or that they were obtained from recycled or scrap sources, in its annual report and in a "conflict minerals report." The conflict minerals report would be furnished as an exhibit to that annual report and would be accompanied by an independent audit report. The conflict minerals report would describe:

1. the measures the company took in its due diligence on the source and chain of custody of the conflict minerals;
2. the certification by the company that it obtained the audit;
3. the company's products that are not "DRC conflict-free";
4. the facilities used to process these conflict minerals;
5. the country of origin of these conflict minerals; and
6. the effort undertaken to determine the mine or location of origin with the greatest possible specificity.

The company would also be required to post on its website copies of the conflict minerals report and the independent private sector audit report, disclose the address of that website in its annual report, and retain the information on its website at least until the company files its next annual report with the SEC.

The conflict minerals report and accompanying audit report would each be “furnished” rather than filed and would therefore not be subject to Section 18 liability or incorporated by reference into any other filing under the Securities Act or Exchange Act unless a company explicitly incorporated it into its filings.

Effective Date

The Dodd-Frank Act requires companies to begin furnishing conflict minerals disclosures for the first fiscal year beginning after the SEC’s publication of final rules. Section 13(p) directs the SEC to publish final rules by April 15, 2011. Accordingly, a calendar-year company would be required to furnish conflict minerals disclosures in its annual report for the year ending on December 31, 2012.

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