Guidance for Compliance with SEC Conflict Minerals Rules

The Securities and Exchange Commission recently adopted final rules requiring disclosure of the use of "conflict minerals" by public companies, pursuant to a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 "intended to further the humanitarian goal of ending the extremely violent conflict in the [Democratic Republic of the Congo], which has been partially financed by the exploitation and trade of conflict minerals originating in the DRC" or surrounding countries. (Read our client alert on the SEC's final rules here.) In light of these final rules, we offer this practical guidance to our clients that may need to conduct a reasonable country-of-origin inquiry regarding their products and how to determine if this is necessary.

Since you are filing reports and other documents with the SEC, you are subject to the new rules regarding conflict minerals if you manufacture or contract for manufacture of any product. No exception exists for smaller reporting companies, voluntary filers, or foreign private issuers, and the analytical procedures we recommend you adopt are being implemented in one form or another at thousands of SEC-reporting companies in the U.S. and around the world.

Getting Ready – Organize and Train the Conflict Minerals Team

To establish a compliance base for the new rules, each reporting company will need to create a working group of personnel who together know what products the company produced during each year (including through its subsidiaries); chemicals used in their manufacture; the raw materials used and third-party-sourced components included in the products; the raw material content of the parts; and the sources of the chemicals, raw materials, and parts. Group members should familiarize themselves with the three-step process for determining the extent of the company's reporting obligations, as we described in our previous client alert and the related SEC Adopting Release and, to the extent practicable, the general overview of the issues involved, contained in the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas.

We recommend, as an initial matter, that an issuer adopt a formal corporate policy regarding maintaining a responsible global supply chain of minerals from conflict-affected and high-risk areas. Although no specific requirement to do so exists, the SEC noted in the Adopting Release that an issuer should describe its conflict minerals policy in its Form SD conflict minerals report. In addition, the benefits of encouraging and fostering a corporate culture of compliance are tangible and should mitigate issuer liability for an individual failure to ensure proper reporting, as well as reflect favorably on the issuer's good faith and in any private-sector audit that may be required, as discussed below. A model policy is available in the OECD Guidance.

We also suggest that you include specific language governing conflict minerals in your purchase orders with your vendors. (See our suggested model language here.)

Step One – Determine Whether Your Products Contain Conflict Minerals

Although each company will create its own method of addressing Step One, based on its method of data collection

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and existing internal control systems, we suggest that a current list of the issuer's product codes, model numbers, or stock-keeping units, taken from the most recent sales books, distributor order forms, or catalogs, could serve as a starting point. Team members drawn from the sales function might review this initial list of products to ensure that outdated products are not included, that "special order" or bespoke products are not overlooked, and that the descriptions contained in the initial list are not too generic or technical for analysis by those working in the compliance function.

The next review of this list is to determine whether your company manufactures or contracts for the manufacture of products that you place into the stream of commerce. Although, according to the SEC, the term "manufacture" is to be given the meaning ascribed in common parlance, the Adopting Release states that the term "contract to manufacture" includes those situations in which an issuer "…has 'any' influence over the manufacture of that product." Also, the SEC "expressed [its] belief that an issuer that offers a generic product under its own brand name or a separate brand name should be considered to be contracting to manufacture that product, if the issuer had contracted to have the product manufactured specifically for itself." As a result, you will need to examine most component supplier relationships to determine whether your company exerts any control over the design or manufacture of the component.

Once you have compiled the final list of products that the company manufactures or contracts to manufacture, the working group should determine whether any such product contains **gold (Au)**, **tin (Sn)**, **tantalum (Ta)**, or **tungsten (W) (each a Potential Conflict Mineral)**. If a product **does** contain any of these elements, the group should determine whether the element is "necessary to the functionality or production" of the product. The SEC included this phrase in its final rules without specific definition, intending that each issuer determine the proper application of the language based on its own facts and circumstances. The SEC included extensive guidance in the Adopting Release on this issue, so we recommend that, unless it is very clear to the relevant engineer that a Potential Conflict Mineral is or is not necessary to functionality or production of a particular product, the team refer the determination to a member of the legal department for further analysis. We note, however, that materials used solely for ornamentation are considered not necessary to the product's functionality but that trace elements in a product left behind from the manufacturing process are considered necessary to its production. Product packaging is not part of a product unless the producer sells the packaging independent of the product itself (in which case it would itself be considered a product).

If you are unable to determine whether any third-party-sourced material or component part does not contain a Potential Conflict Mineral, you should inquire of your vendor.

If none of the products that you manufacture or contract for manufacture contain any Potential Conflict Mineral necessary to the functionality or production of the product, then no further analysis is necessary and you need not proceed to Step Two.

Step Two – Reasonable Country of Origin Inquiry (RCOI)

After reducing the list of products to those containing Potential Conflict Minerals necessary to the products' production or functionality, the working group must conduct an RCOI to determine whether the Potential Conflict Minerals came from one of the Covered Countries – the DRC or a country that shares a border with the DRC (*i.e.*, Angola, Burundi, the Central African Republic, Republic of Congo, Rwanda, South Sudan, Tanzania, Uganda, or Zambia).

As with the "necessary to the production or functionality" determination, the SEC has declined to issue specific factors that would satisfy the RCOI standard, stating that "such a determination depends on each issuer's particular facts and circumstances. What is reasonable can differ among issuers based on the issuer's size, products, relationship with suppliers or other factors." On the other hand, a few basic elements emerge from a review of the Adopting Release:

- You must reasonably design an RCOI to determine if a Potential Conflict Mineral originated in a Covered Country or from recycled or scrap sources;
- You must perform an RCOI in good faith – in other words, it is insufficient to design an RCOI but then fail to undertake the steps necessary to carry it out;
- You may rely on representations of the facility at which the Potential Conflict Minerals were processed, if the facility has been audited by a recognized trade association; and
- Failure to receive representations from all suppliers or processors would not prevent you from concluding that your products are "conflict free," absent any red flags.

Compliance tools, such as lists of conflict-free smelters and a Conflict Minerals Reporting Template and Dashboard, which includes forms of vendor questionnaires and cover letters, are available at http://www.conflictfreesmelter.org. You might also consult with industry trade groups with respect to RCOI initiatives.

Step Three – Due Diligence Inquiry and Conflict Minerals Report/Private-Sector Audit

If you are able to conclude, based on the RCOI, that the identified Potential Conflict Minerals did not originate in the Covered Countries or, alternatively, that you have no reason to believe that the Potential Conflict Minerals may have originated in the Covered Countries or reasonably believe they came from recycled or scrap sources, then you must file with the SEC a Form SD (Special Disclosure) to disclose this determination and briefly describe the RCOI you undertook. If you are unable to so conclude, a more extensive process is mandated, which Loeb & Loeb would need to discuss separately with your conflict minerals working group.

In light of the need to address these issues by the end of 2013, if you have not already done so, we strongly encourage you to begin organizing the activities you should be undertaking and to develop a timetable to ensure compliance. As usual, please feel free to contact us with any questions you may have.

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