Client Alert

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SEC Staff Provides Guidance on Conflict Mineral and Resource Extraction Disclosure Requirements

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On May 30, 2013, the staff (the "Staff") of the U.S. Securities and Exchange Commission (the "SEC") published Frequently Asked Questions ("FAQs") regarding certain disclosures required under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").[1] The new FAQs provide important guidance to issuers regarding disclosures they may be required to make in connection with products containing conflict minerals and certain payments made by resource extraction issuers.

BACKGROUND

Title XV of the Dodd-Frank Act, entitled "Miscellaneous Provisions," contains these "specialized corporate disclosure" provisions, which include:

- *Conflict Minerals*. Section 1502 of the Dodd-Frank Act requires issuers to disclose annually whether any "conflict minerals" that are "necessary to the functionality or production" of a product of the issuer originated in the Democratic Republic of the Congo or an adjoining country and, if so, to provide a report describing, among other matters, the measures taken to exercise due diligence on the source and chain of custody of those minerals. This disclosure must include an independent private sector audit of the report that is certified by the issuer.
- *Resource Extraction Payments*. Section 1504 of the Dodd-Frank Act requires issuers engaged in the commercial development of oil, natural gas, or minerals to disclose, in an annual report, certain payments made to the United States or a foreign government.

In August 2012, the SEC adopted final rules establishing the process by which issuers provide the disclosures required by the specialized corporate disclosure provisions.[2] Pursuant to these rules, issuers are required to provide such disclosures using the newly promulgated Form SD. Disclosures made pursuant to the Conflict Minerals Rule are included under Item 1.01 of Form SD, while disclosures under the Resource Extraction Rule are included under Item 2.01 of Form SD.

Since the adoption of the new rules, issuers have raised a variety of questions with the Staff regarding the scope of the specialized corporate disclosure requirements. In the FAQs, the Staff has attempted to respond to several of the most common inquiries.

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[1] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act Frequently Asked Questions: Conflict Minerals (May 30, 2013), available at http://www.sec.gov/divisions/corpfin/guidance/conflictminerals-faq.htm (the "Conflict Minerals FAQs"); Dodd-Frank Wall Street Reform and Consumer Protection Act Frequently Asked Questions: Disclosure of Payments by Resource Extraction Issuers (May 30, 2013), available at http://www.sec.gov/divisions/corpfin/guidance/resourceextraction-faq.htm (the "Resource Extraction FAQs").

[2] *See* Conflict Minerals, Exchange Act Release No. 34-67716 (Aug. 22, 2012); Disclosure of Payments by Resource Extraction Issuers, Exchange Act Release No. 34-67717 (Aug. 22, 2012); *see also* 17 C.F.R. 13p-1 (the "Conflict Minerals Rule"); 17 C.F.R. 240.13q-1 (the "Resource Extraction Rule").

CONFLICT MINERALS GUIDANCE

The Conflict Minerals FAQs provide guidance regarding the disclosure requirements under the Conflict Minerals Rule, including:

- *Types of Issuers Covered*. The Conflict Minerals Rule applies to all issuers that file reports with the SEC under Exchange Act Sections 13(a) or 15(d), whether or not the issuer is required to file such reports (thereby including so-called "voluntary files"). Registered investment companies that are required to file reports pursuant to Rule 30d-1 under the Investment Company Act are not subject to the Conflict Minerals Rule.
- *Mining Activities Do Not Trigger Disclosure*. Issuers that only engage in activities customarily associated with mining (including gold mining of lower grade ore) are not considered to be "manufacturing" those minerals and are not required to make disclosures under Item 1.01 of Form SD.
- *Consolidated Subsidiaries Covered*. Issuers must determine the origin of conflict minerals, and make any required disclosures regarding such minerals, for themselves and all consolidated subsidiaries.
- *Etching a Logo or Identifier Not Considered Contracting to Manufacture*. In the commentary to the Conflict Minerals Rule adopting release, the SEC noted that an issuer is not considered to be "contracting to manufacture" a generic product if its actions involve no more than "affixing its brand, marks, logo, or label to a generic product manufactured by a third party." In the FAQs, the Staff indicated that etching or otherwise marking a generic product, manufactured by a third party, with a logo, serial number, or other identifier is not considered to be "contracting to manufacture."
- *Generic Components Require Inquiry*. Issuers are required to conduct a reasonable country of origin inquiry with respect to conflict minerals included in generic components included in products they manufacture or contract to manufacture. There is no distinction between the components of a product that an issuer directly manufactures or contracts to manufacture and the "generic" components of a product the issuer purchases to include in a product.
- *Packaging Not Part of Products*. The packaging or container sold with a product is not considered to be part of the product for purposes of the Conflict Minerals Rule. This is true even if a product's package or container is necessary to preserve the usability of the product up to and following the product's purchase. If, however, an issuer manufactures and sells packaging or containers independent of the product, the packaging or containers, in that circumstance, would be considered a product.
- *Equipment Used to Provide Services Not Considered Products*. The Staff indicated that it "would not object if issuers did not file reports . . . regarding the conflict minerals in the equipment that they manufacture or contract to have manufactured if that equipment is used for the service provided by the issuer and the equipment is retained by the service provider, is required to be returned to the service provider, or is intended to be abandoned by the customer following the terms of the service." The Staff further indicated that it does not consider equipment used to provide services to be products under the Conflict Minerals Rule.
- *Tools, Machines, and Equipment Not Considered Products*. An issuer's tools, machines, or other equipment that it manufactures or contracts to have manufactured are not considered "products" of that issuer. Even if such tools, machines or other equipment are later sold by the issuer, the Staff will not view the items' entry into the stream of commerce as transforming them into products of the issuer.
- *Form S-3 Eligibility*. The failure by an issuer to timely file Form SD for disclosures required under the Conflict Minerals Rule does not impact an issuer's eligibility to file a registration statement on Form S-3.

RESOURCE EXTRACTION GUIDANCE

The Resource Extraction FAQs also provide useful guidance on several topics related to disclosure requirements under the Resource Extraction Rule, including:

- *Subsidiaries and Controlled Companies*. Payments made to governments by the issuer, a subsidiary of the issuer, or an entity under the control of the issuer must be disclosed by the issuer. A reporting issuer that is not engaged in commercial development activities itself but which has a subsidiary or entity under its control that engages in those activities would be considered a resource extraction issuer and would be subject to the resource extraction disclosure requirements.

- *Service Providers Are Not Resource Extraction Issuers*. Companies providing only services associated with resource exploration, extraction, processing, and export generally would not be considered to be "resource extraction issuers." By way of example, the Staff noted that it does not believe companies that provide hardware and logistics to help companies explore for or extract resources would be considered to be exploring for or extracting the resources even though their services are being used to explore or extract. Similarly, the Staff stated that it does not believe a company engaged by an operator to provide hydraulic fracturing services or drilling services for the operator, thus enabling the operator to extract resources, would be considered to be a resource extraction issuer. If, however, a service provider makes a payment on behalf of a resource extraction issuer that falls within the definition of "payment" under the Resource Extraction Rule, the resource extraction issuer must disclose such payments.

- *"Mineral" Definition*. For purposes of the Resource Extraction Rule, disclosure is required with respect to "any material commonly understood to be a mineral, which would include any material for which disclosure would be required under Industry Guide 7, 'Description of Property by Issuers Engaged or to be Engaged in Significant Mining Operations,' notwithstanding any test of materiality used for purposes of Guide 7."

- *Transportation Activities*. If an issuer transports resources across international borders and has an ownership interest in such resources, the Staff indicated that it would consider the issuer to be a resource extraction issuer. The Staff also indicated, however, that it would not consider an issuer to be a resource extraction issuer if it merely transported resources in which it did not have an ownership interest across international borders.

- *Cash Basis Reporting*. Payments required to be disclosed under the Resource Extraction Rule should be presented on an unaudited, cash basis for the year in which the payments are made.

- *No Requirement to Segregate Taxable Income*. If a resource extraction issuer pays taxes on multiple sources of income in a particular country and is required to disclose such tax payments under the Resource Extraction Rule, the issuer may either (1) elect to segregate income from exploration, extraction, processing, and export from income earned on other business activities, and disclose only income taxes paid solely on the income generated by the commercial development activities or (2) report the aggregate tax payment and disclose that the reported payment information includes payments made for purposes other than commercial development activities.

- *Form S-3 Eligibility*. The failure by an issuer to timely file Form SD for disclosures required under the Resource Extraction Rule does not impact an issuer's eligibility to file a registration statement on Form S-3.

CONCLUSION

As a reminder, the new reporting requirements under the Conflict Minerals Rule are now in effect for the calendar year ending December 31, 2013, and any required disclosures must be included in a report on Form SD filed by May 31, 2014. Disclosures required under the Resource Extraction Rule must be included in a report on Form SD filed within 150 days after the conclusion of any fiscal year ending after September 30, 2013. Issuers who have

not already done so should begin to assess their compliance with, and implement appropriate disclosure controls and procedures regarding, these new disclosure requirements.

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