

Client Alert.

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California to Require its Contractors to Comply with SEC Conflict Minerals Reporting Obligations

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On September 16, 2011, the California Legislature passed SB 861,^[1] a law that requires public companies contracting with the State of California to ensure that their supply chains are free of “conflict minerals” sourced from the Democratic Republic of the Congo (“DRC”). These companies may face a regulatory compliance burden in the future if they wish to maintain their business relationships with the state.

BACKGROUND TO SB 861

SB 861 requires public companies, or issuers, that contract with California state agencies to comply with forthcoming Securities and Exchange Commission (“SEC”) regulations on conflict minerals.^[2] The SEC regulations arise, in turn, from the “conflict minerals rule,” part of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). The conflict minerals rule aims to curtail funding sources for armed groups in the DRC by requiring the SEC to impose public disclosure and reporting requirements on issuers that use “conflict minerals”—gold, tantalum, tin, and tungsten—in their manufacturing processes. These minerals are vital components of cell phones, computers, and other consumer electronics products. Proponents of the conflict minerals rule have asserted that open disclosure and reporting of sourcing practices will encourage issuers to seek these minerals only from sources that are “conflict free.”

OBLIGATIONS UNDER SB 861 AND TIMEFRAME FOR ADOPTION

SB 861 requires issuers that do business with the State of California to fulfill the public reporting obligations outlined in the forthcoming SEC regulations. Issuers that fail to meet these obligations will be prohibited from seeking procurement contracts with the state.

Affected issuers should start thinking about steps to ensure compliance. The bill will become operative on the latter of January 1, 2012, or the date on which the SEC issues its final conflict minerals regulations, which is expected to be before the end of 2011. Affected issuers will need to provide initial conflict minerals disclosures and reports after the first full fiscal year following adoption of the law.

IMPACT OF SB 861 ON ISSUERS CONTRACTING WITH CALIFORNIA OR OTHER GOVERNMENT ENTITIES

Although the SEC regulations are not yet finalized, they may impact public companies that do business with California. At the federal level, non-compliant issuers could be subjected to administrative proceedings before the SEC. At the California state level, however, non-compliance will simply mean being barred from contracting with any California state agency for goods or services.

^[1] http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_0851-0900/sb_861_bill_20110913_enrolled.pdf.

^[2] For further information on the forthcoming SEC regulations, please see “Conflict Minerals in the Democratic Republic of Congo: New Proposed SEC Regulations to Impact Japanese Manufacturers,” available at <http://www.mofo.jp/topics/legal-updates/tlcb/20110322.html>.

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Even issuers that do business solely with states other than California should monitor developments in the conflict minerals regulatory regime. Although California currently is the only state that requires compliance with the SEC regulations, it is possible that other states, or even municipalities, could follow suit in the near future.

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