SEC Proposes "Conflict Minerals" Disclosure Rules to Implement Dodd-Frank Provisions

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The U.S. Securities and Exchange Commission has proposed specific rules to implement the Dodd-Frank Act requirements for audits and reports by public companies to show whether certain minerals used in their manufactured goods originate in war-torn Congo or adjoining countries in Africa. The law is intended to address widespread corruption, human abuse and genocide in that region by imposing supply-chain due diligence on manufacturers that use in their products "conflict minerals" that fund groups responsible for the atrocities. Public U.S. manufacturers should closely monitor and comment on this rulemaking to ensure practicable compliance.

As reported earlier in July 2010, Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) amended Section 13 of the Securities Exchange Act of 1934 to impose a new reporting requirement on publicly traded companies that manufacture products for which "conflict minerals" are necessary to their functionality or production. (See "The 'Conflict Minerals' Provision in the Dodd-Frank Act Imposes New Disclosure Requirements on Manufacturers" for more information.) The U.S. Securities and Exchange Commission (SEC) has now issued proposed rules to implement several sections of the Dodd-Frank Act, including section 1502. The proposed rule is available in a December 23, 2010, *Federal Register* notice. Final regulations must be issued by April 15, 2011, and the requirements of Section 1502 will become effective for a company's first full fiscal year following issuance of final rules, *i.e.*, the first full fiscal year after April 2011.

Under the proposed rules, public companies that manufacture products, or contract to have products manufactured, for which conflict minerals—cassiterite, columbite-tantalite, gold, wolframite or their derivatives (including tin and tungsten)—are "necessary to the functionality or production" would be required to disclose whether the conflict minerals used in production originated in the Democratic Republic of Congo (DRC) or an adjoining country. The proposed rules consider a company to be "contracting to manufacture" a product if the company has any influence over the product's manufacturing, or if it contracts specifically to have the product manufactured regardless of influence over the manufacturing process. For example, a company would be subject to the proposed rules if it sells under its brands a generic product containing conflict minerals, even if it has the product manufactured by another company. The requirements do not apply to shippers, trading companies, resellers and others that do not manufacture products. However, the proposed rules do include mining companies as

"manufacturers" of the minerals they mine, subjecting companies that extract conflict minerals and those who contract for such extraction to the proposed rules' disclosure requirements.

Subject companies would base the required determination on a reasonable country of origin inquiry. SEC Chairman Mary L. Schapiro has stated that because the SEC does not have expertise on the issues surrounding the violence in the DRC, the SEC has hewn closely to the statute in the proposed rule and will take public comments into account when adopting a final rule.

If a company determines that the conflict minerals used in its products did *not* originate in the DRC or an adjoining country, the rule would require only that the company disclose this determination on its website, provide the URL in its annual report and maintain records supporting the determination.

The rule would impose more onerous requirements on any public company that *does* find it uses in its manufacture of products conflict minerals originating in the DRC or adjoining countries, or that cannot affirmatively determine that conflict minerals used in its products do *not* originate from the DRC or an adjoining country. Such company must disclose this fact in its annual report to the SEC and furnish a Conflict Minerals Report as an exhibit. The Conflict Minerals Report must also be made available on the company's website and the URL must be provided to the SEC.

The Conflict Minerals Report must describe the measures taken by the company to exercise due diligence in the sourcing and the chain of custody of the conflict minerals. This must include a certified independent audit of the Conflict Minerals Report conducted by an independent auditor according to standards established by the Comptroller General of the United States and rules adopted by the SEC. The audit must be furnished along with the Conflict Minerals Report and must also include descriptions of the products manufactured, or contracted to be manufactured, that contain conflict minerals that are not "DRC Conflict Free" (defined by the statute to mean products that do not contain materials that directly or indirectly finance or benefit armed groups in the DRC or an adjoining country), the facilities used to process those minerals, their country of origin and what efforts were undertaken to determine the mine or location of origin with the greatest possible specificity. Companies would also be required to disclose the due diligence used in making their determinations, *e.g.*, whether any national or international standards were consulted.

The proposed rules recognize the difficulty in ascertaining the origin of conflict minerals that are sourced through recycling or scrap. Accordingly, the proposed rules would allow recycled/scrap minerals to be treated as DRC Conflict Free. However, issuers that use such recycled/scrap minerals in their

manufactured products would have to provide reasons and show due diligence for believing the minerals are truly from recycled or scrap sources in their Conflict Minerals Report. Sellers of recycled/scrap minerals, particularly gold, have voiced concerns that the rule may disadvantage their products as compared with mined minerals actually shown to be conflict free, principally because issuers buying recycled/scrap minerals for use in their manufactured products still would be required to file a Conflict Minerals Report subject to the audit requirement.

The SEC is accepting public comments on the proposed rule until January 31, 2011. Requests for further clarification and relaxation of some elements of the proposal are expected from several interested industries.