



Preparing for Compliance with the SEC's Conflict Minerals Rule: Challenges Ahead!



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- **Overview of presentation**
- **Introduction of speakers**
- **Foley Hoag LLP is the only law firm member of the Conflict Minerals Consortium – a consortium of service providers providing legal, supply chain, and upstream due diligence services to corporate clients**



www.conflictmineralsconsortium.com

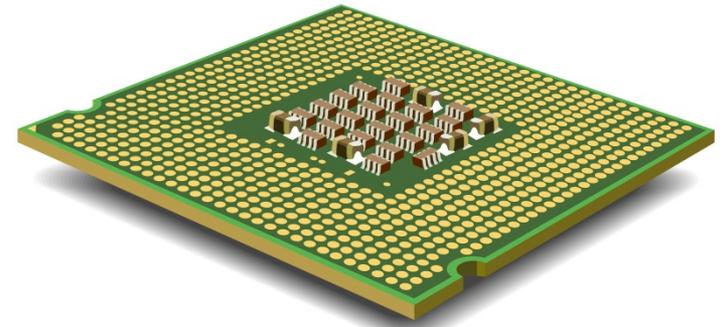
■ Section 1502 of the Dodd-Frank Act

- Directed the Securities and Exchange Commission (“SEC”) to issue a rule establishing disclosure requirements for issuers for which conflict minerals are necessary to the functionality or production of a product manufactured, or contracted to be manufactured, by the issuer.
- Intended to address the humanitarian crisis in the Democratic Republic of Congo (“DRC”), and concerns that sales of specific minerals are funding armed groups in the ongoing conflict.

■ Final rule issued on August 22, 2012; effective date November 13, 2012; compliance required beginning January 1, 2013.

Overview of the Rule: Conflict Minerals

- **Conflict minerals include:** cassiterite and its derivative, tin; columbite-tantalite, and its derivative, tantalum; gold; and wolframite, and its derivative, tungsten.
- Conflict minerals are widely used by manufacturers of many products, including: electronic components, automotive parts, medical devices, jewelry, and industrial machinery; some uses are not obvious.
- “DRC Conflict Free”: products that do not contain conflict minerals that directly or indirectly finance or benefit armed groups in the DRC or an adjoining country (the “Covered Countries”).



Overview of the Rule: Key Steps

- **Step 1: Determine if the rule applies.**
 - Are you an issuer required to file periodic reports with the SEC? (includes foreign private issuers)
 - Do you manufacture, or contract for the manufacture, of products?
 - Do any of your products contain one of the listed conflict minerals?
 - If so, is the conflict mineral necessary to the functionality or production of the product?
- **Step 2: If “yes,” conduct Reasonable Country of Origin Inquiry (“RCOI”) to determine whether materials originated in a Covered Country (special treatment of scrap/recycled material).**
- **Step 3: If “yes,” or if unable to determine origin, engage in due diligence on sourcing of materials (including audit); report to SEC.**

Overview of the Rule: Reporting Requirements

- Issuers that utilize conflict minerals must disclose, on an annual basis, whether those minerals originated in Covered Countries.
- Issuers must file a Form SD and, if applicable, an attached Conflict Minerals Report under the Securities Exchange Act.
 - A Conflict Minerals Report must include an independent private sector audit report.
- Form SD is “filed” and subject to liability under Section 18 of the Exchange Act for material misstatements or omissions; private right of action available.



Overview of the Rule: Key Dates

- Issuers subject to the rule must **comply beginning on January 1, 2013.**
- Reports issued pursuant to the final rules must cover the calendar year with reports due on May 31 of the following year.
 - First reports due on May 31, 2014.
- Issuers that utilize conflict minerals are exempted from the rule if those minerals are “outside the supply chain” prior to January 31, 2013.



Overview of the Rule: Transition Period

- During a two-year transition period, issuers may be eligible to describe their products as “DRC conflict undeterminable.”
- The transition period is four years for “smaller reporting companies” (less than \$50 million annual revenue).
- Issuers with products that may be described as “DRC conflict undeterminable” must still file a Conflict Minerals report, but the report does not need to be audited.



Recycled or Scrap Sources

- **Recycled metals:** reclaimed end-user or post-consumer products, or scrap processed metals created during product manufacturing.
- **Scrap:** includes excess, obsolete, defective and scrap metal materials appropriate to recycle in the production of tin, tantalum, tungsten and/or gold.
- Conflict minerals sourced from recycled or scrap material are generally exempt from reporting.



■ Manufacturer

- Not defined in final rule – “generally understood”
- Intended to be broad; includes assembly.
- Does not include issuers who only service, maintain, or repair products containing conflict minerals.

■ Contract to Manufacture

- Includes issuers that contract for the manufacturing of components of their products.
- Includes issuers that have actual influence over the manufacturing of their products.
 - *i.e.*, with regard to materials, parts, ingredients, or components to be included in product.
- Does not include resellers that only affix brand or logo to generic products.



Step 1: Are Conflict Minerals “Necessary”?

- **Conflict Minerals must be “necessary to the functionality or production” of a product**
 - Was the conflict mineral intentionally added?
 - What is the generally expected function, use, or purpose of the product, and is the mineral “necessary” to that?
 - If the conflict mineral is for ornamentation or decoration, is ornamentation or decoration the purpose of the product?
 - Must be contained in the final product.
 - If conflict minerals used in production of the product, even trace amounts in final product trigger the rule.
 - Could include packaging, if packaging is necessary to the functionality of the product (*e.g.*, food or drug packaging).
 - Depends on facts and circumstances of the issuer.
- **No *de minimis* exception.**

Step 2: Reasonable Country of Origin Inquiry

- **Purpose**: To determine whether necessary conflict minerals may have originated in the Covered Countries *or* are from recycled or scrap sources.
- Covered Countries include: DRC, Angola, Burundi, Central African Republic, Republic of Congo, Rwanda, Sudan, Tanzania, Uganda, and Zambia.



Step 2: Reasonable Country of Origin Inquiry

- **Must be reasonably designed and conducted in good faith.**
 - “A reasonable country of origin inquiry can differ among issuers based on the issuer’s size, products, relationships with suppliers, or other factors.”
- **SEC’s Guidance:**
 - It would suffice to seek and obtain **reasonably reliable representations**:
 - Identifying the facility at which minerals were processed; and
 - Demonstrating that minerals did not originate in covered countries OR came from scrap or recycled sources.
 - Issuer **must have reason to believe that representations are true** and must take into account warning signs – “red flags.”
 - Representations can be from processing facilities or immediate suppliers. 100% response rate is not *required* (but unclear what is *sufficient*).

Step 2: After RCOI, is Due Diligence Required?

- If after a RCOI, the issuer can state that conflict minerals necessary to the functionality or production of its products:
 - did not originate in the Covered Countries, or
 - did come from recycled or scrap sources;

OR

- The issuer has no reason to believe that its conflict minerals may have originated in the Covered Countries;

OR

- The issuer reasonably believes that its conflict minerals are from recycled or scrap sources.

Then -- No Due Diligence is Required.

The issuer is only required to file a Form SD disclosing its determination and providing an overview of the RCOI and its results.

Step 3: Due Diligence

- **An issuer must perform due diligence on the source and chain of custody of conflict minerals if it:**
 - Knows that conflict minerals originated in Covered Countries and did not come from scrap or recycled sources; or
 - Has reason to believe that conflict minerals may have originated in Covered Countries.



Step 3: What is “Due Diligence?”

- **Supply chain investigation:** processes to trace the source (back to the smelter and mine) and the chain of custody of issuer’s conflict minerals.
 - Conflict Minerals Report must describe issuer’s **“efforts to determine the mine or location of origin with the greatest possible specificity.”**
- **Not limited to inquiry:** may also require changes in issuer’s procurement policies and practices to reduce risk of sourcing materials from conflict-affected areas.
- **Must follow a nationally or internationally recognized “framework.”**
 - *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas* is currently the only recognized due diligence framework for the covered conflict minerals.

Step 3: Reporting on Due Diligence

- **If, after due diligence, an issuer determines that its conflict minerals did not originate in Covered Countries or did come from scrap or recycled sources:**
 - The issuer does not have to file a Conflict Minerals Report, but must still file Form SD describing: its determination, its due diligence process, and the results of its due diligence efforts.
- **If, after due diligence, the issuer determines that conflict minerals did originate in Covered Countries and did not come from recycled or scrap sources:**
 - The issuer must submit a Conflict Minerals Report.
- **If, after due diligence, the issuer cannot determine the source of its conflict minerals:**
 - The issuer must submit a Conflict Minerals Report.

Step 3: The Conflict Minerals Report

- **The Conflict Minerals Report is an attached exhibit to Form SD.**
- **The Conflict Minerals Report must include:**
 - a description of the issuer’s due diligence efforts;
 - a description of any products found not to be “DRC Conflict Free”;
 - the facilities used to process the conflict minerals used in those products; and
 - the country of origin of those conflict minerals.

Step 3: The Transition Period

- An issuer may use the **“DRC conflict undeterminable”** designation if:
 - **it knows, or has reason to believe, that it utilizes conflict minerals that originated in the Covered Countries, and**
 - after conducting due diligence, it is unable to determine whether those conflict minerals financed or benefited armed groups;
 - OR**
 - **it has reason to believe that the conflict minerals may have originated from the Covered Countries and may not have come from recycled or scrap sources, and**
 - after conducting due diligence, it is unable to determine: the country of origin of the conflict minerals, whether those conflict minerals financed or benefited armed groups, or whether the conflict minerals came from recycled or scrap sources.
- ***The issuer must still file a Conflict Minerals Report, but it does not need to be audited.***

Step 3: Due Diligence Audit Requirements

- Due diligence measures must include an independent private sector audit of the Conflict Minerals Report.
- **Audit standard**: GAO’s existing Government Audit Standards (“GAGAS”).
- **Audit Objective**: The audit must express an opinion or conclusion as to:
 - whether the ***design*** of the issuer’s due diligence measures conforms to the criteria in the applicable due diligence framework; and
 - whether the issuer’s ***description*** of its due diligence measures in the Conflict Minerals Report is consistent with its actual efforts.

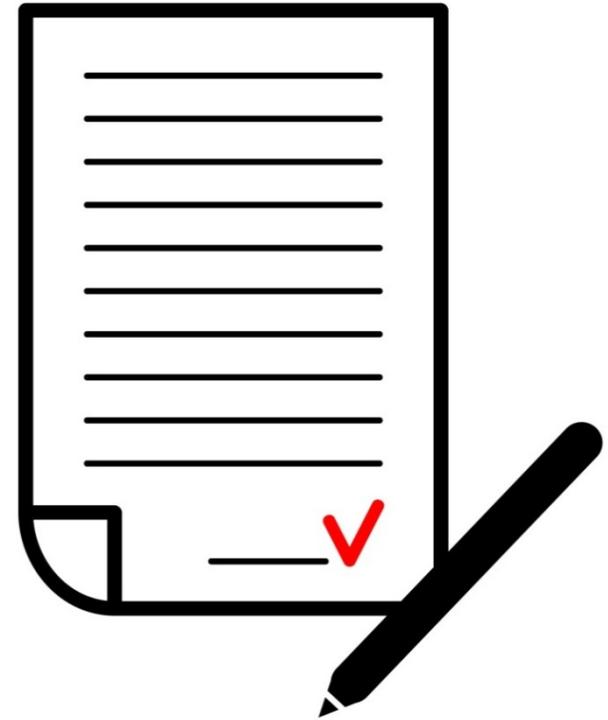


Step 3: Due Diligence Audit Requirements

- Auditors can use GAGAS provisions for:
 - Attestation Engagement (certified public accountant required), or
 - Performance Audit (CPA not required).
- SEC guidance: same firm may audit financial statements and Conflict Minerals Report.
- Auditors must comply with GAO auditor independence standards.
 - Independence likely impaired if same firm provides due diligence services and audit of Conflict Minerals Report.
- Due diligence services and audits of Conflict Minerals Reports are “non-audit services,” subject to Audit Committee pre-approval and proxy statement disclosure.
- Impact on voting recommendations by proxy advisory firms?

What Now? Key Considerations

- **Start right away: It will take time to develop a compliance strategy that is:**
 - Appropriate to the nature of your operations.
 - Designed to generate information for relevant reporting and disclosure timeframes and auditable.
- **Begin by assessing:**
 - Products and manufacturing processes.
 - Number of suppliers and market leverage.
 - Find out about existing industry initiatives:
 - industry standard processes or materials (*e.g.*, EICC-GeSI).
 - processing facilities certified as “conflict free” by recognized industry groups?



Making an Action Plan: Practical Steps

1) Organize a cross-functional conflict minerals working group:

- Include all relevant functions (engineering, manufacturing, purchasing, sales and marketing, finance, legal, IR).
- Include senior-level executives: need buy-in, resources and “tone at the top.”
- Assign a budget.

2) Identify and retain outside advisors:

- Due diligence design consultants, auditors, counsel.



3) Design a process covering:

- Characterization of products and manufacturing processes.
- Identification of suppliers; RCOI inquiry process; follow-up.
- Design and execution of Step 3 due diligence program, if necessary.
- Selection of auditor and conduct of audit.
- Preparation of Form SD and Conflict Minerals Report.
- Communications with appropriate stakeholders.

4) Carefully document plan and process:

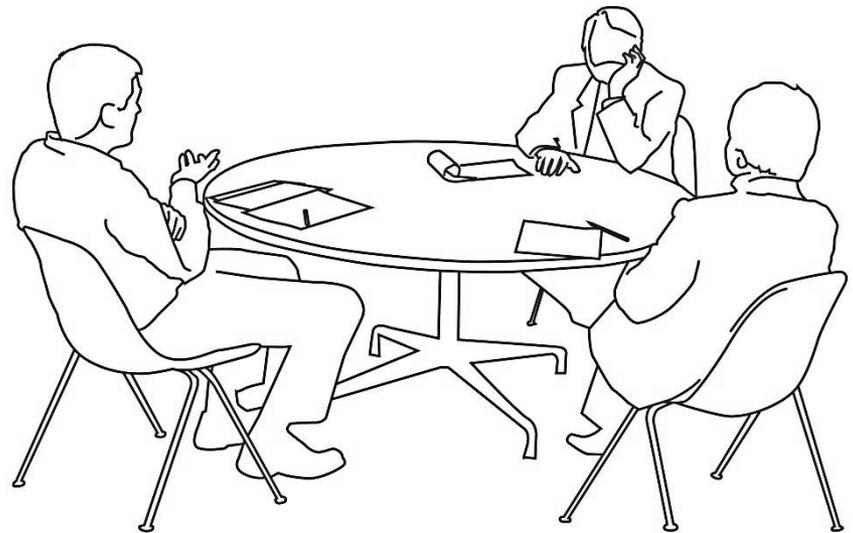
- Personnel and governance.
- Each process step: who, what, where, when and how.
- Rationale and criteria for key decisions (*e.g.*, characterization of products, vendor selection, RCOI determination, etc.).
- Copies of all supporting documentation, sign-offs, etc.

Making an Action Plan: Practical Steps



- 5) **Start reaching out to key suppliers and customers:**
 - Ask what your suppliers are already doing; don't just hit them with a big questionnaire.
 - Find out what your key customers are thinking, and reassure them that you are working to be ready to comply.
- 6) **Develop a communications plan for all interested stakeholders:**
 - Investors, suppliers, customers, employees, consumers, watchdog groups.
 - What *is* your corporate strategy and policy regarding sourcing of materials from DRC?

- 7) Consider up front whether a “two-step” process is realistic:**
- Are you likely to get to a favorable RCOI determination?
 - If not, consider starting “step 3” diligence right away.
 - May still conclude no Conflict Minerals Report necessary.
- 8) More “radical” steps:**
- Stockpile pre-January 31, 2013 materials?
 - Shut down or sell off affected products or operations?



Questions?

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