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Client Alert

Energy & Natural Resources Practice

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Dodd-Frank's "Conflict Minerals" Provision: *Expected to Impact Nearly Half of All U.S. Public Companies*

UPDATE: SEC delays final rules until at least August, 2011

Tucked into the sweeping 2,200 page Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or the "Act") is a provision that requires companies that file annual reports with the SEC to disclose in those reports specific information related to their resource supply chains and manufacturing processes.

Specifically, Section 1502 of the Act applies to companies that file Form 10-K, 20-F, or 40-F annual reports with the SEC and use so-called "conflict minerals," to disclose whether those minerals came from the Democratic Republic of the Congo (DRC) or an adjoining country. These reporting obligations apply if the role of these minerals is determined to be "necessary to the functionality or production of a product manufactured."

What materials are subject to disclosure requirements?

The "conflict minerals" are gold, wolframite, cassiterite, columbite-tantalite (coltan) and their derivatives, including metals such as tungsten, tin, and tantalum. Common applications of these materials include solder, carbide tools, jet engine parts, wires, and electrodes.

There is no *de minimis* exception to the application of these requirements. So long as one of these conflict minerals is necessary to the functionality or production of a product manufactured by a company, that company must undertake to make disclosures.

Which industries will it impact?

The disclosure requirements are expected to apply to more companies than might first have been expected — possibly 6,000 out of 13,000 public companies. This is due to the widespread use of conflict minerals, and the SEC's application of the disclosure requirements to both companies that directly manufacture products and to companies that contract for the manufacture of their products (*i.e.*, private-brand or generic products).

Industries that commonly utilize the subject minerals include aerospace, automotive, defense technology, electronics and communications, jewelry, and medical device manufacturers, among others.

For more information, contact:

Ken Culotta
+1 713 276 7374
kculotta@kslaw.com

Tim Engel
+1 202 661 7800
tengel@kslaw.com

Jeff Perry
+1 202 626 5521
jperry@kslaw.com

King & Spalding
Houston
1100 Louisiana Street
Suite 4000
Houston, Texas 77002-5213
Tel: +1 713 751 3200
Fax: +1 713 751 3290

Washington, D.C.
1700 Pennsylvania Avenue, NW
Washington, D.C. 20006-4707
Tel: +1 202 737 0500
Fax: +1 202 626 3737

www.kslaw.com

What additional requirements will Section 1502 impose?

The SEC proposed rules require three tiers of analysis for determining the level of disclosure required by a company.

- The initial determination should be whether conflict minerals are necessary to the functionality or production of a product manufactured by the company. If not, the company is not subject to the disclosure requirements. The SEC proposes to include both manufacturers and companies that contract for the manufacture of their products. Mining conflict minerals is currently considered to be a manufacturing process.
- If conflict minerals are determined to be "necessary to the functionality or production" of a company's product, the next step is to determine whether those conflict minerals originated in the DRC or an adjoining country (the "DRC Countries"). The DRC Countries are the Democratic Republic of the Congo, Angola, the Republic of Congo, the Central African Republic, the Sudan, Uganda, Rwanda, Burundi, Tanzania, and Zambia.
    - If the company determines that its conflict minerals did not originate in the DRC or an adjoining country, the company is required to disclose this determination and the type of inquiry it used in the determination in its annual report to the SEC.
    - Alternatively, if the company determines that its conflict minerals did originate in DRC Countries, or if it is unable to establish the origin of its conflict minerals, the company is required to disclose this information in its annual report.
    - The SEC will conduct a reasonableness review of the reliability of the method used by each company to trace the origin of its conflict minerals.
- Finally, companies that use conflict minerals from DRC Countries and those that cannot determine the source of their conflict minerals are required to furnish a separate Conflict Minerals Report, including:
    - a description of the products manufactured or contracted to be manufactured that are not (or might not be) DRC conflict free (*i.e.*, products containing "conflict minerals");
    - the facilities used to process the conflict minerals, the country of origin of the conflict minerals (if known), and the efforts to determine the mine or location of origin with the greatest possible specificity;
    - a description of the measures taken by the person to exercise due diligence on the source and chain of custody of such minerals; and
    - an independent private sector audit of the Conflict Minerals Report conducted in accordance with standards established by the Comptroller of the United States and rules recognized by the SEC in consultation with the Secretary of State.

The SEC proposed that companies that obtain their conflict minerals from recycled or scrap sources may consider those minerals to be "DRC conflict free." The company would, however, be required to provide a Conflict Minerals Report describing the due diligence measures that were used to determine that the conflict minerals stemmed from recycled or scrap sources.

When will the disclosure requirements take effect?

Section 1502 requires companies to provide their initial conflict minerals disclosure and, if necessary, their initial Conflict Minerals Report after their first full fiscal year following the promulgation of the final rules. Assuming the SEC adopts final rules in late 2011 (August to December), the first reporting period will be for the company's fiscal year ending in or after late 2012.

The SEC proposed rules have generated significant public interest, so much so that the initial comment period was lengthened by 30 days and the timeframe for issuance of final rules has been delayed by at least four months. It is difficult to predict what, if any, changes the SEC will make to the final rules. However the SEC is likely to consider the underlying policy goals of accountability, transparency, and public awareness, given the broad ambit of the enabling legislation.

Why opt for a legislative solution?

Congress deemed this legislation necessary in order to help stem the tide of violence and exploitation in the DRC and neighboring countries.[1] The DRC provides five percent of the world's tin supply and 14 percent of the coltan from mines that are, in many cases, controlled by the armed groups that foment this violence. The reporting requirements are part of an effort to reduce the flow of money to the groups to purchase weapons and are intended to foster "ethical sourcing" by disclosing corporate procurement practices and subjecting them to public scrutiny. States are exerting pressure as well. California has already introduced legislation that would prevent the letting of state procurement contracts to companies whose products are not "DRC conflict free."

What are its likely ramifications?

King & Spalding will be working closely with our clients to review the final rules once they are published by the SEC. In the meantime, we recommend that companies with the potential to be affected by these rules work to review and solidify their supply chain management procedures and practices. Companies should also take into account the possibility of public relations issues stemming from the disclosure of due diligence results. Activist shareholders are likely to seize upon disclosures as an impetus for some form of advocacy activity embracing the themes of supply chain sustainability and corporate social responsibility.

[1] See Maylie, Devon, "Firms Seek Supply Route Around Conflict in Congo" The Wall Street Journal (April 27, 2011) available at http://online.wsj.com/article/SB10001424052748704530204576236132463855532.html#ixzz1Kjc05SO0