VENABLE® LLP

Client Alerts

December 2012

Developments in Eastern Congo Highlight Need for Companies to Prepare for SEC Conflict Mineral Rule Compliance

SEC rule calls for conducting supply chain due diligence and reporting on origin of certain minerals

AUTHORS

Lindsay B. Meyer
Eric R. Smith
William N. Hall
Parker B. Morrill
Ariel S. Wolf
Carrie A. Kroll

RELATED PRACTICES

International Trade and Customs
Corporate Finance and Securities
Environmental Law

ARCHIVES

2012 2008 2004
2011 2007 2003
2010 2006 2002
2009 2005

Recent gains by rebel groups in the mineral-rich eastern region of the Democratic Republic of Congo ("DRC") have complicated efforts for U.S. companies to comply with a new Securities and Exchange Commission ("SEC") rule targeting "conflict minerals."

The SEC finalized its Conflict Minerals Rule (the "Rule") in August 2012. The Rule requires public companies to determine whether their products contain minerals mined from sources that benefit armed groups in the DRC or certain adjoining countries. The recent capture of a key commercial city in eastern DRC by armed rebel groups has compromised supply chains and made procurement of conflict-free minerals more difficult.

What Minerals and Origins Are Involved?

"Conflict Minerals" include cassiterite (and its derivative tin), columbite-tantalite (and its derivative, tantalum), wolframite (and its derivative, tungsten), and gold. If these minerals are necessary to the functionality or production of a product, public companies will need to determine whether these minerals have been mined in the DRC or adjoining countries, i.e., Angola, Burundi, Central African Republic, the Republic of the Congo, Rwanda, South Sudan, Tanzania, and Uganda ("Covered Countries").

What Steps Do You Need to Take?

Affected companies are required to file a report for their 2013 calendar year activities on or by May 31, 2014. This means that starting in January 2013, a company must have a proper compliance program in place to be able to file a complete 2013 report or to document a determination that the Rule does not apply.

Companies should consult with counsel to understand their obligations and prepare a strategy, under the protections of privilege, to provide a compliant response. The following provides some key background information on the new rule to get started.

Threshold Determinations

- Does the company file reports with the SEC, i.e., is it a public company?
- Does the company manufacture or contract to manufacture products for which conflict minerals are necessary to the product's functionality or production?

If the answer to either of these questions is "yes," the disclosure requirements will potentially apply and your company may need to file a report or determine whether the conflict minerals come from the Covered Countries. And, if the response to both questions is "no," then you must be able to substantiate how this determination was made.

Thus far, the SEC has provided only general guidelines on how to interpret the phrases "necessary to the functionality" and "necessary to the production." As such, companies should consult with counsel before making a final determination on these questions.

Reasonable Country of Origin Inquiry

If the answer to both of the above questions is "yes," the company will need to conduct in good faith a reasonable country of origin inquiry to determine whether any of the conflict minerals used in its products originated in the Covered Countries. A company may satisfy the "reasonable country of origin inquiry" standard if it seeks and obtains reasonable representations that identify the facility at which its

conflict minerals were processed and demonstrate that (i) those conflict minerals did not originate in the Covered Countries or (ii) they came from recycled or scrap resources. A company may avoid further due diligence requirements if, based on the inquiry, the company:

- Determines that its conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources;
- Has no reason to believe its conflict minerals originated in the Covered Countries; or
- Reasonably believes that its conflict minerals came from recycled or scrap sources.

Although further due diligence is not required if the company makes one of the conclusions above, the company must still make certain disclosures in a form filed with the SEC, known as "Form SD."

Supply Chain Due Diligence

If after conducting a country of origin inquiry, a company has reason to believe that their conflict minerals may have originated in the Covered Countries and are not from scrap or recycled sources, the company must: (i) conduct due diligence on the origin of its conflict minerals and (ii) attach a Conflict Minerals Report and an independent auditor report as exhibits to its Form SD. Due diligence steps may include the following:

- In conducting its diligence, a company is required to conform to a nationally or internationally recognized due diligence framework, if available for the relevant conflict mineral;
- If the results of diligence determine that the conflict minerals did not originate in the Covered Countries or did come from recycled or scrap sources, the company must only file a Form SD that discloses its determination and briefly describes its country of origin inquiry and diligence efforts and results;
- If the results of diligence lead to any other conclusion, the company must prepare a Conflict Minerals Report, which must be audited, and file it as an exhibit to its Form SD; and
- The Conflict Minerals Report must also be made available on the company's website.

International Trade and Conflict Minerals Rule Compliance

Certain aspects of the Conflict Minerals Rule exceed the typical scope of the SEC's expertise, such as evaluating applicable country of origin and auditing an international logistics and supply chain. In the absence of clear guidance or precedent, companies seeking to comply with the Rule will have to draw from analogous concepts used in international trade law.

For instance, the Rule requires a company to conduct a reasonable country of origin inquiry to determine whether any of the conflict minerals used in its products originated in the Covered Countries. While uncommon in securities law, a country of origin inquiry is a routine part of any customs analysis, and experienced trade counsel are well-suited to assist clients in conducting this inquiry, relying upon established rulings and case law precedence for similar origin determinations. Likewise, tracing materials in downstream production through a manufacturing supply chain are also common principles employed in international trade with established import and export regulations and programs, for which experienced trade counsel can assist.

Moreover, as companies investigate their supply chains for the purpose of complying with the Conflict Minerals Rule, it is critical to also understand potential exposure to other international trade laws and regulations. For example, the U.S. Department of Treasury's Office of Foreign Assets Control ("OFAC") enforces targeted economic sanctions specific to the DRC, one of the Covered Countries where the conflict minerals at issue are mined. Like all sanctions programs administered by OFAC, the DRC sanctions apply to "U.S. persons" and are transaction-based. Companies that discover supply chain issues relating to conflict minerals for the purpose of the Conflict Minerals Rule may need legal counsel to evaluate whether their activities also constitute violations of U.S. economic sanctions or other export control laws, for which extensive penalties may apply.

Looking Ahead

On October 19, 2012, a lawsuit challenging the SEC's Conflict Minerals Rule was filed with the Court of Appeals for the D.C. Circuit by the National Association of Manufacturers and the U.S. Chamber of Commerce. The lawsuit challenging this new rule puts in question the actions required by companies and their suppliers. Nonetheless, the prudent course for companies is to prepare for the 2013 reporting period.

Next Steps

Compliance with the new Conflict Minerals Rule may require significant time and money. The first reporting period under the Rule begins January 1, 2013. Therefore, companies will need to:

- Determine whether the Rule applies to their products or business and ensure that they have the proper compliance programs in place when the reporting period begins;
- Review their budgets to adjust for country of origin inquiries or conflict minerals due diligence;
- Analyze contracts with suppliers, and review conflict minerals representations and warranties in such agreements;
- Review and revise, as necessary, any purchasing policies and agreements;
- Analyze contracts with suppliers, and review conflict minerals representations and warranties in such agreements;
- Review and revise, as necessary, any purchasing policies and agreements; and
- Develop training programs for employees, build tracking systems, and establish procedures with third parties.

By working through these challenges now, a company can avoid unnecessary expense, liability, shareholder action, or even bad publicity.

If you are unsure about the Rule's application to your business or need guidance in building a compliance program for your company, please contact your Venable attorney or a member of the Venable Conflict Minerals Compliance Team, listed above.

Venable's Conflict Minerals Compliance Team

Venable's Conflict Minerals Compliance Team consists of experienced attorneys capable of assisting clients in all aspects of compliance with the Conflict Minerals Rule. These attorneys have decades of experience working with the SEC, U.S. Customs and Border Protection, OFAC, and other agency stakeholders in the development and implementation of Dodd-Frank's Conflict Minerals requirement. Our attorneys include a former staff member in Congress with first-hand experience working on the Conflict Minerals Rule as well as a former member of the SEC staff, a licensed U.S. Customs Broker, and several attorneys with extensive experience guiding companies through analogous regulatory compliance program demands.