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CLIENT MEMORANDUM

Companies Adopt Varying Approaches to Disclosure Under SEC Conflict Minerals Rule

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AUTHORS

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June 2, 2014, marked the deadline for compliance with the U.S. Securities and Exchange Commission's ("SEC" or "Commission") Conflict Minerals Disclosure Rule ("the Rule"). By the end of the day, 1,300 publicly traded companies had filed 2,265 reports, including the required specialized disclosure form ("Form SD") and associated exhibits (i.e., conflict minerals reports). This briefing recounts the Rule's background and basic requirements, and offers an "initial take" on companies' varying approaches to meeting their disclosure obligations.

SEC's Conflict Minerals Disclosure Rule

By establishing new corporate disclosure requirements under Section 1502 of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"), Congress chose to further its goal of ending human rights abuses and violent conflict in the Democratic Republic of the Congo ("DRC") by targeting one source of financing for such abuses—the exploitation and trade of conflict minerals. Specifically, Congress directed the SEC to promulgate disclosure and reporting regulations for the use of "conflict minerals," defined as tantalum, tin, tungsten, and gold ("3TG metals") sourced from the DRC or an adjoining country. Pursuant to Congress' edict, the Commission proposed a rule to implement Section 1502 in December 2010 and adopted the final version of the Rule in August 2012.

As enacted, the Rule required companies subject to the disclosure requirements to conduct a Reasonable Country of Origin Inquiry ("RCOI") to determine whether any 3TG metals in their products came from covered countries. The Commission refused to include a *de minimis* exemption in the Rule. If a company discovered, or had a "reason to believe," that minerals in its products (i) did not come from recycled or scrap sources, and (ii) came from covered countries, the company was then required to conduct due diligence on the source and chain of custody in its supply chain(s). The company had to hire a private, independent third party to audit its diligence process and then submit an associated report of findings. Following the diligence inquiry and auditing process, companies then had to identify their products as "DRC conflict free" or not, and publish such information in a report to the SEC and on their websites. However, during the Rule's initial two- to four-year phase-in period, companies would be allowed to skip the auditing requirement by indicating that they had conducted the RCOI and due diligence in good faith, but that their products were conflict "undeterminable."

In advance of the filing deadline, the SEC published a Draft Form SD ("Draft Form"), which provided instructions on the type of information to be reported (i.e., due diligence and product descriptions) and on preparing the conflict minerals report. The utility of the Draft Form was somewhat limited, however, because the instructions did not include specific criteria concerning key aspects such as level of detail and clarity. For example, as to due diligence, the Draft Form stated that the process had to: conform to a nationally or internationally recognized framework; include an independent private sector audit conducted in accordance with standards established by the Comptroller General of the U.S.; and for any products classified as "conflict undeterminable," disclose steps to mitigate the risk that using conflict minerals in products did, or will, benefit armed groups. For products, other than those classified as "DRC conflict free," the Draft Form required: a description of the products; a list of facilities used to process the necessary conflict minerals; and "if known," the country of origin or a description of efforts made to determine the mine or country of origin "with the greatest possible specificity."

Before the Rule took effect, the National Association of Manufacturers, the U.S. Chamber of Commerce, and the Business Roundtable (Plaintiffs/Appellants), filed suit alleging that the Rule violated First Amendment rights by compelling commercial speech. *National Association of Manufacturers v. SEC,* No. 13-5252 (D.D.C. July 2, 2013). On April 14, 2014, the U.S. Court of Appeals for the District of Columbia issued its Opinion, agreeing in part with Appellants on First Amendment grounds, but otherwise ruling in favor of the SEC by upholding the remainder of the 2012 final version of the Rule, including the Commission's decision not to include a *de minimis* exemption. As a result, the SEC revised the Rule to conform with the Court's Opinion, eliminating the part of the Rule that would have required companies to specifically declare whether or not their products contain conflict minerals.[1]

Inaugural Filings

By June 11, 2014, companies had filed a total of 2,300 reports under the Rule. Filers came from many sectors of the economy, including energy, retailers, manufacturers, electronic and technology industries, pharmaceutical and healthcare

[1] On May 14, 2014, the D.C. Circuit denied appellants' emergency motion for a stay of the Rule. Currently pending is the SEC's challenge of the Court's decision to strike part of the Rule on First Amendment grounds.

companies, industrial and construction suppliers, and networking and telecommunications companies. Because the SEC failed to specify in either the Rule or Draft Form the level of detail and clarity required, the level of transparency in the initial filings varies considerably.

Some companies adopted a minimalist approach, limiting disclosure to the following:

- A brief description of the company's operations and the primary markets or sectors it services.
- General descriptions of its product lines.
- A statement that its products and assemblies include devices and components that may contain conflict minerals.
- General descriptions of the company's: due diligence process; compliance with the OECD Due Diligence Guidance; supply chain survey; inability to get information from all suppliers or determine the country of origin; and, decision to opt-out of the auditing requirement during the phase-in period.
- A summary of findings.
- Planned mitigation efforts moving forward, which often include continued engagement with suppliers and the goal of improving rate and quality of responses.

Other companies provided a greater degree of disclosure, encompassing the areas above as well as the following:

- A detailed description of the company's corporate history, operations, retail locations, and corporate governance policies (including a Conflict Minerals Policy, also included in the Report).
- Descriptions of a comprehensive due diligence process, including information about: design (key elements/factors included in its assessment); application of various domestic and international standards, including the Conflict-Free Smelter Program; specific policies related to its supply chain, transparency, and conflict minerals, and integration of these policies into larger corporate operations; details on supplier engagement; steps taken to identify the location of mines and the origin of minerals; and, any use of a third-party consultant.
- The results of the company's diligence process, such as the specific percentage of its suppliers that contracted to manufacture products that contain necessary conflict minerals.
- Additional mitigation efforts, such as its process for identifying current high-risk suppliers and details of its strategy to address future risks, its development of a risk management plan and/or monitoring requirements, as well as the involvement of senior management.

Finally, a smaller group of companies disclosed even more information than those in the groups above by providing the following:

- Detailed descriptions of all aspects of the design components of the company's conflict minerals program, as well as more specific product information.
- A description of a due diligence process that included: performance of mitigation efforts to bring suppliers into compliance with internal policies; visits to smelter and refiner facilities to obtain country of origin and chain of custody information; and monthly progress reports submitted to senior-level management.
- The report prepared by an independent private sector auditor.
- Tables listing each 3TG metal and the individual smelter or facility that processed the necessary conflict minerals (globally), as well as designating those classified as "conflict free" by the third-party audit program.
- A description of its planned mitigation efforts to obtain conflict-free supply chain for all products.

Conclusion

Look for such variability to continue until a "best practice" standard emerges. In the interim, companies with disclosure obligations under the Rule should watch for informal guidance from the Commission and seek feedback on their inaugural filing from other relevant stakeholders.[2]

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[2] See *Expectations Shortlist: Company Conflict Mineral Reporting and Activities*.