

International Trade Alert

Conflict Minerals Update: Letter From Congress Indicates SEC Final Rule is Imminent

February 17, 2012

A joint letter from Sen. Patrick Leahy, Rep. Howard Berman and others to the Securities Exchange Commission (SEC) indicates that the SEC has completed a working draft of final rules implementing the “conflict minerals” disclosure requirements directed by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) and that publication of the final rules may be imminent. The letter sheds light on the content of the unpublished draft-final rules.

Background

Section 1502 of the Dodd-Frank Act amends Section 13 of the Securities Exchange Act of 1934 (the “Exchange Act”), 15 U.S.C. § 78. New subsection (p) of Section 13 is intended to limit trade in certain “conflict minerals” originating from sources controlled by armed groups operating in the Democratic Republic of Congo (DRC) and adjoining countries and to decrease the violence funded by such trade. New subsection (p) imposes new reporting requirements on certain issuers of securities registered with the SEC and tasks the SEC with promulgating implementing regulations. In December 2010 the SEC published a Notice of Proposed Rulemaking (NPRM).

Under the SEC’s proposed implementing rules:

- Conflict minerals and their common derivatives are columbite-tantalite (coltan or tantalum), cassiterite (tin), wolframite (tungsten) and gold.
- Any issuer of U.S. securities who is otherwise required to file a report with the SEC would be subject to the reporting requirements if conflict minerals are necessary to the functionality or production of a product that they manufacture or contract to be manufactured.
- Companies that are otherwise exempt from filing reports with the SEC or whose products do not contain conflict minerals would be exempt from the new reporting requirements.
- Covered issuers would be required to determine and disclose in their annual reports to the SEC and on their public websites whether their manufactured goods contain conflict minerals (or their derivatives) that originated in the DRC or adjoining countries.
- Issuers whose products include DRC or adjoining country conflict minerals would also be required to conduct “supply chain due diligence” in an effort to certify that their conflict minerals do not “directly or indirectly finance or benefit armed groups” in the DRC or adjoining countries.



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- Any required supply chain due diligence efforts and conflict minerals certifications must be documented in a “Conflict Minerals Report” that must be accompanied by a certified private-sector audit.

The SEC originally estimated that the new requirements would impact nearly 6,000 international trading companies, including manufacturers (and, in some cases, retailers) of technology, telecommunications, aerospace, automotive, electronics, industrial, jewelry and children’s toy products, to name a few. In reality, the impact of the new rules will likely be felt throughout the manufacturing and retail supply chains as covered reporting entities begin imposing conflict minerals tracing requirements on their suppliers.

Timing

The Dodd-Frank Act required the SEC to publish final rules by April 15, 2011. After a deluge of comments, however, the SEC delayed the initial implementation of a final rule. Initial disclosures and reports will be due beginning with the first full fiscal year following the promulgation of final regulations. Accordingly, companies with a December 31 fiscal year-end will first be required to submit a report with respect to fiscal year 2013.

Additionally, many of the comments submitted to the SEC by industry representatives have urged a phased in implementation of the new reporting requirements based on the logistical difficulty of tracing conflict minerals through diffuse supply chains. For example, commentators have suggested full implementation by 2015. At this time, however, the SEC has not suggested that it will adopt staggered implementation in its final rules.

Indications of Elements of the Final Rule

The letter submitted to the SEC by Sen. Leahy, Rep. Berman and others sheds light on some potentially important aspects of the SEC’s draft-final rules.

The letter criticizes the SEC’s draft final rules for allowing reporting issuers to “furnish” rather than “file” conflict minerals reports with the Commission. The “furnish” vs. “file” distinction was also included in the Commission’s NPRM. The practical impact of the “furnished” vs. “filed” distinction is that “furnished” information is not automatically incorporated by reference into a reporting issuer’s filings with the Commission and is not subject to liability under Section 18 of the Exchange Act. Section 18 of the Exchange Act makes reporting issuers liable for “false or misleading statements” if investors rely on such statements when purchasing or selling securities at a price which was affected by such statements. Reporting issuers who are required to “furnish” information to the SEC as an exhibit to an annual filing may still be subject to liability for violations of Sections 13(a) or 15(d) of the Exchange Act if they fail to furnish a required exhibit or if the required exhibit is “unreliable”. Penalties for such violations may be injunctive, civil or criminal and may also extend to individual executives of the issuer.

The letter also indicates that the Commission’s final rule may include an “indeterminate” country of origin category. As summarized above, under the NPRM, reporting entities would be required to undertake three basic reporting steps.

- First, issuers must determine whether they are subject to the reporting requirements.
- Second, covered issuers must undertake a reasonable country of origin inquiry to determine whether conflict minerals necessary to the functionality or production of a product that they manufacture or contract to have manufactured originated in the DRC or adjoining countries.
- Third, under the NPRM, if the entity concludes on the basis of its reasonable country of origin inquiry that its conflict minerals (a) originated in the DRC or adjoining countries, or (b) that the country of origin could not be determined, the entity is required to furnish a full conflict minerals report and independent private sector audit.

Accordingly, the NPRM can be read as requiring a conflict minerals report unless a covered reporting entity can demonstrate that its conflict minerals did not originate in the DRC or adjoining countries.

Multiple private industry stakeholders have commented on the practical impossibility of tracing conflict minerals through diffuse and complex supply chains back to their source. Some have advocated for the creation of an indeterminate country of origin category. If the Commission's final rule adopts an indeterminate country of origin category, reporting entities would likely be exempt from preparing and furnishing costly conflict minerals reports and private sector audits if, after reasonable efforts, they are unable to conclusively show that their conflict minerals did not originate in the DRC or adjoining countries. It must be noted, that the Commission has not yet defined "reasonable" in the country of origin inquiry context.

Pending Updates

We are tracking the status of the final rules closely and will issue additional alerts and analysis as we receive additional information.

CONTACT INFORMATION

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