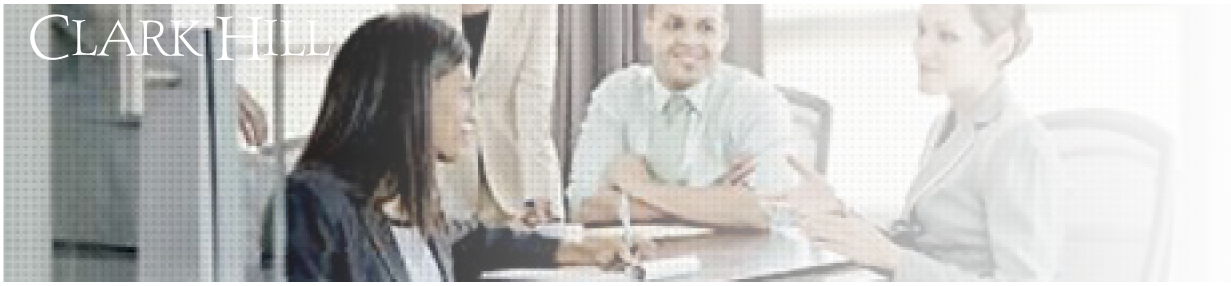

CONFLICT MINERALS AND ASSOCIATED RISKS: THE DEADLINE IS NEAR

By Jane C. Luxton

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act established a new set of Securities & Exchange Commission (SEC) disclosure requirements, focused on the presence in manufactured products of four common metals – tin, tantalum, tungsten, and gold, sometimes called the "3T/Gs," for short. In finalizing its conflict minerals implementing rule in 2012, the SEC set May 31, 2014, as the first reporting deadline. While some manufacturers have invested the considerable resources necessary to satisfy these new obligations, surveys as recent as December 2013 have found that a great many companies were unprepared for this fast-approaching deadline. And even those that have taken steps to comply may not realize some corporate risks associated with supply chain diligence and transparency programs like the conflict minerals initiative, such as brand reputational exposure and heightened attention to anti-bribery law enforcement. Savvy businesses should be considering measures to reduce vulnerability on multiple fronts as they implement new conflict minerals policies and procedures.

<u>Conflict Minerals Rule Requirements</u>. In enacting section 1502 of the Dodd-Frank Act, Congress sought to use SEC reporting obligations to force-start a supply chain transparency regime, and thereby create disincentives to the use of so-called conflict minerals mined under certain circumstances in the Democratic Republic of the Congo (DRC) and eight surrounding countries in Central Africa. As envisioned, the harsh spotlight would divert investment away from and eliminate cash flow to warlords in the DRC responsible for a bloody campaign of violence against their countrymen. Although even the new chair of the SEC has questioned the wisdom of conducting foreign policy through the vehicle of U.S. securities reporting requirements, nonetheless the new rules compel publicly traded companies – and by implication, their upstream suppliers – to trace the origins of any 3TGs contained in their manufactured products, all the way back to the mine.

Manufacturers whose products contain the covered metals must conduct a "reasonable country of origin" inquiry, seeking information from vendors on whether the metals come from (1) recycled materials, (2) locations in the DRC or surrounding countries, (3) known sites elsewhere, or (4) unknown sources. Depending on the answer, companies must undertake further diligence, potentially including an independent third-party audit. Regardless of the ultimate source of the metals, publicly traded companies must disclose the scope of their inquiry and file a Form SD with the SEC. Even those not subject to SEC reporting requirements – whether located in the U.S. or abroad – are being drawn into challenging diligence obligations by customers that are demanding their suppliers obtain the needed information.

<u>Costs and Scope</u>. The costs of this new program are substantial. The SEC estimated costs of $3 to $4 billion, but the National Association of Manufacturers projected a much higher number, on the order of $9 to $10 billion for just the initial phase of compliance. The 3TGs are ubiquitous in manufactured goods, in products and components ranging from electronics to wiring, seat cushions, plastics, batteries, tools, glass, sensors and systems, some pesticides, and even clothing and shoes.

Adding to the initiative's sweeping breadth, the SEC's final rule declined to provide an exception for de minimis quantities, so even trace amounts of these metals trigger the conflict minerals disclosure requirements. In addition, the final rule incorporated broad and in some cases ambiguous terms, for example indicating that, in the case of catalysts, unless all of the catalyst material washed out of the product, it must be considered present and subject to the rule's coverage.

<u>Implementation</u>. A workable compliance process involves the following fundamental steps:

- *Establish an internal system for managing the process.* Many companies are creating a conflict minerals management team, with representatives from purchasing, legal, finance, engineering, sustainability or environmental affairs, communications, and government relations. Support from upper management is crucial to ensuring the success of this team's efforts.

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• *Engage the supply chain.* Either by internally determining what products contain conflict minerals or by reaching out to all vendors, the team must contact suppliers and request that they undertake a reasonable country of origin inquiry on any conflict minerals in products or components sold to the company. A focused questionnaire may be useful in this process, and some online tools are available to assist in supply chain inquiries. The team must be prepared to gauge the quality of the response in determining what follow-up effort will be needed to obtain the necessary information. It is helpful to set a single point of contact to deal with supplier questions and confusion, as well as for coordinating leverage to be used on those suppliers that are not responsive.

• *Have a plan in place for conducting necessary supply chain diligence.* For the first two reporting years (2014-2016), the SEC will permit companies to report that the origins of conflict minerals in their products are not determinable, but this does not mean manufacturers can ignore the country of origin inquiry, due diligence, or independent audit requirements. On the contrary, Form SD filings must describe the efforts the company has made and what measures it plans to use to improve reporting for following years, with the goal of providing full details on the source of the conflict minerals by the end of the two-year grace period (four years for small companies).

• *Meet the deadline for the SEC reporting requirements.* The conflict minerals team must work with upper management and SEC compliance counsel to ensure that the company's Form SD (newly released by the SEC)– and related website disclosure obligations – are ready by the May 31, 2014 deadline. The SEC's final rule references the Conflict Minerals Diligence Framework of the Organisation for Economic Development and Cooperation (OECD), which includes among its elements the publication of a business's Conflict Minerals Policy, and companies need to be developing such a policy at the same time as they are carrying out their other conflict minerals implementation efforts. Strategically minded businesses should consider integrating their conflict minerals policy with other sustainability policies.

Other considerations. The European Union and Canada are also pursuing conflict minerals legislation, and companies with international operations – or customers – should be monitoring those initiatives as well. But more broadly, the SEC reporting requirements are just the tip of the iceberg in corporate risk calculations in this area. Supply chain transparency regimes are proliferating, under pressure from non-governmental organizations that believe "name and shame" programs have enormous power to change corporate behavior by spotlighting socially or politically undesirable procurement decisions. Just as adverse publicity has had negative impacts on businesses accused of relying on "slave labor," conflict minerals advocacy groups are publishing ratings of companies, based on their disclosure and use of metals sourced in the DRC and surrounding countries. Brand protection considerations may far outweigh the risks of SEC action as a motivating factor for well-informed companies contemplating a response to conflict minerals reporting requirements.

Another potential vulnerability companies must manage is the possibility that supply chain diligence will uncover problematic practices, for example conduct that falls afoul of the Foreign Corrupt Practices Act (FCPA) or international analogues like the UK Anti-Bribery Law. The US Justice Department and SEC have vigorous FCPA enforcement programs in force and a record of securing significant corporate and individual penalties against those violating the law. Prudent companies are taking steps to shore up their FCPA compliance programs in coordination with the new conflict minerals diligence requirements.

Conclusions. Experience is indicating that far more companies face conflict minerals compliance obligations in 2014 than their management teams may have realized. There is still time to put in place an effective readiness program, but this will require substantial effort and full management commitment. As the first critical deadline approaches, this issue should be a top line priority in C suites throughout the country.

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