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CONFLICT MINERAL RULES: FREQUENTLY ASKED QUESTIONS

The Securities and Exchange Commission's (SEC) conflict mineral rules, adopted in August 2012, present hard questions for public companies, which must evaluate whether they are covered by the rules, and, if so, make inquiry into the origin of the minerals used in their products. The rules are complex and leave much to interpretation based on particular facts and circumstances. Further, the rules endorse an international due diligence framework that is somewhat untested and will continue to evolve as the impact of the rules takes effect.

This advisory reviews a range of questions that companies are addressing under the rules. Although we expect the staff of the SEC to give guidance on some of these, it is not clear when, or to what extent, that will happen, and we caution that many of the questions covered in this advisory must be interpreted by companies based on their own situations.

BRIEF BACKGROUND ON THE CONFLICT MINERAL RULES

The SEC adopted the conflict mineral rules under Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") on August 22, 2012.[1] The rules require public companies annually to disclose information about their use of specific minerals originating and financing armed groups in the Democratic Republic of the Congo ("DRC") or an adjoining country. The "conflict minerals" are tantalum, tin, tungsten, and gold.[2] The rules will encompass many public companies because conflict minerals are used to manufacture a wide array of products, such as smartphones, cameras, computers, microchips, automobiles, tools and heavy machinery.

The rules envision a three-step compliance process, as follows:

FIRST, a company must determine whether it is covered by the rules based on its use of conflict minerals.

SECOND, a company that is covered by the rules must conduct, in good faith, a "reasonable country of origin inquiry" that is reasonably designed to determine if the conflict minerals originated in the covered countries or are from recycled or scrap sources.

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[1] *See Conflict Minerals*, Rel. No. 34-67716 (Aug. 22, 2012) ("Adopting Release"). The text of the final rules is included in the Adopting Release which is available on the SEC's website.

[2] More precisely, "conflict mineral" means columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives. Section 13(p)(5) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 1502(e)(4) of the Dodd-Frank Act. The SEC's rules modify this definition slightly by stating that the derivatives of these minerals are limited to tantalum, tin and tungsten. Item 1.01(d)(3) of Form SD. The Secretary of State can designate additional conflict minerals by making a determination that the minerals or their derivatives are financing conflict in the DRC or an adjoining country. To date, the Secretary of State has not made such a determination.

THIRD, a company that determines that its conflict minerals originated in the covered countries and are not from recycled or scrap sources, or has reason to believe that its conflict minerals may have originated in the covered countries and may not be from recycled or scrap sources, must exercise due diligence on the source and chain of custody of its conflict minerals and may need to file a Conflict Minerals Report.

Annex A contains a helpful flow chart from the Adopting Release illustrating this three-step compliance process.

All disclosures required under the rules will be filed using a newly-created form, Form SD. The first reports containing required conflicts mineral disclosure will cover the calendar year beginning January 1, 2013, which means that any public companies that have not yet begun to assess their status under the rules should act quickly.[3] Although the rules have been challenged in court, the outcome of the legal challenge is unclear, and, for now, we recommend that public companies proceed to comply with the rules in the form adopted.[4]

For a detailed description of the new rules, please see our firm's client advisory on the new rules.

STEP ONE - DETERMINING WHETHER A COMPANY IS COVERED BY THE RULES

A company will be covered by the rules if it meets the following two criteria:

- it files reports with the SEC under Section 13(a) or 15(d) of the Exchange Act (this includes domestic companies, foreign private issuers, and smaller reporting companies), and
- conflict minerals are necessary to the functionality or production of a product manufactured by the company or contracted by the company to be manufactured.

Although the first of these criteria is generally straightforward, the use of the term "registrant" in the rules creates at least some question as to whether a company's subsidiaries and other related entities are covered by the rules. While there is no clear answer in the rules, we believe the term "registrant" in this context could well be interpreted to cover a company's subsidiaries, and, likely, its controlled (or at least consolidated) entities. Nonetheless, it will be important to review any applicable guidance offered by the SEC staff on this issue.

The second of these criteria use terms that are not defined in the rules, such as "product," "manufacture," "contract to manufacture," and "necessary to the functionality or production." The meaning of these terms must be interpreted and applied by companies based on their specific facts and circumstances, and in light of the somewhat limited guidance offered by the SEC in the Adopting Release. Below are a number of questions that public companies may wish to consider when determining whether they are covered by the rules.

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[3] The first Form SD's, in respect of the year ending December 31, 2013, will be due by May 31, 2014.

[4] A petition for review of the rules was filed with the Court of Appeals for the D.C. Circuit on October 19, 2012 by the National Association of Manufacturers and the U.S. Chamber of Commerce (the Business Roundtable subsequently joined as an additional petitioner). Among the issues raised by petitioners is whether the SEC's economic analysis of the new rules is inadequate, whether the SEC should have included a *de minimis* exception under the rules, and whether certain provisions in the rules, such as covering companies that "contract to manufacture" products containing conflict minerals, are erroneous, arbitrary and capricious, or an abuse of discretion.

Is there any guidance on the meaning of "product"?

There is very little guidance from the SEC on the meaning of "product" in the context of the rules. The term is significant because the rules apply to "products" containing conflict minerals. Thus, it is important for companies, as a threshold matter, to define what constitutes a product for purposes of the rules. In this regard, some companies have pointed to the distinction between "products" and "services" as one way to bound the inquiry (although mixed offerings that incorporate both products and services muddy this distinction). Others have raised questions about whether a "product" should be viewed as including the packaging or its other means of delivery.

While the Adopting Release does not directly address the question of what constitutes a product, it does suggest that, in order to be covered by the rules as a product, an item must be entered into the stream of commerce by being offered to third parties for consideration.

For products or services that are delivered to consumers using a device or mechanism containing conflict minerals, how is the "product" defined?

There are myriad products and services that are delivered to consumers using a device or mechanism that might not be considered a core part of the product or service in the eyes of the consumer. Examples include, among other things, cable television programming delivered by means of a set-top box, music or software delivered by means of compact disc, and movies or other video programs delivered by means of a DVD.

If a delivery mechanism is separately sold or rented to the consumer apart from the related product or service, as is often the case with a cable set-top box, for example, the delivery mechanism is arguably entered into the stream of commerce and, consistent with the guidance in the Adopting Release, would potentially be considered a "product" covered by the rules.

Where there is no separate consideration paid for the delivery mechanism, it is still necessary to ask whether the delivery mechanism is so bound up in the functionality of the product as to be appropriately considered part of the product itself. Numerous scenarios implicate this issue. For example, software is a product which, on its own, does not contain conflict minerals, but which may be delivered to the consumer using a device or mechanism (such as a compact disc) which might contain conflict minerals. Another example is music, movies or other entertainment, which consumers may obtain over the internet, but which also can be delivered by means of a device or mechanism such as a DVD that might contain conflict minerals.

As a separate inquiry, even where the delivery mechanism is determined to be part of the product, a company might consider whether any conflict mineral included in the delivery mechanism is "necessary to the functionality" of the product in question.

What steps should a company take to determine whether its products contain conflict minerals?

The rules do not lay out specific steps that must be followed. We expect that many companies are assembling internal, multi-disciplinary teams and are reviewing documents such as bills of materials, purchase contracts, material safety data sheets (MSDS), product specifications, and statements of work, among other things, to get at the issue of what minerals are included in a product. In all likelihood, many companies will also engage with suppliers, even beyond the first tier, to ascertain the mineral content of their products. The OECD Due Diligence Guidance[5] provides useful guidance

[5] The Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (2011) (the "OECD Due Diligence Guidance"), was published by the Organisation for Economic Cooperation and Development (the "OECD"). This guidance incorporates a Tin, Tantalum and Tungsten

on steps a company can take to engage with its suppliers to obtain information about the mineral content of its products.

Is there a *de minimis* exception under the rule?

No. The SEC stated in the Adopting Release that it would be contrary to the statutory provision to include an exception for products containing only *de minimis* amounts of a conflict mineral. As a result, even trace amounts of conflict minerals can be considered necessary to the functionality or production of the product.

On the other hand, the Adopting Release makes clear that *some* amount of conflict mineral must actually be contained in the product in order to be within the scope of the rules. This is an important threshold concept and also represents an important change from the proposed rules, which, the SEC had suggested, would cover not only conflict minerals contained in a product, but also conflict minerals that were intentionally included in the production process of the product, even if they were not contained in the finished product.

Is there any guidance on the meaning of "manufacture"? Does it include the assembly of products?

There is no definition of the term "manufacture" in either the rules or the Adopting Release because the SEC believes the term is generally understood. However, the Adopting Release states that the SEC does not consider a company to "manufacture" a product if it only services, maintains or repairs the product.

The Adopting Release also states that the North American Industry Classification System's (NAICS) definition of "manufacturer" is too narrow in that it appears to exclude an issuer that manufactures a product by assembling the product from materials, substances or components that are not in raw material form. As a result, the Adopting Release goes on to say, this definition would exclude large categories of issuers that manufacture products through assembly, such as auto and electronics manufacturers. Thus, absent further staff guidance, we think it is likely that a company that assembles its products using component parts would be viewed as the "manufacturer" of that product.

By contrast, if a company contracts with a manufacturer to assemble that manufacturer's products for a fee, we think such company would most appropriately be viewed as providing a service, and not selling a product. This assumes that the assembler in this scenario does not itself sell the products into the stream of commerce for its own account.

What factors should be considered in determining whether a company "contracts to manufacture" a product or component?

Whether a product is "contracted to be manufactured" by a company depends on the degree of influence the company exercises over the manufacturing of the product, including its influence over the materials, parts, ingredients or components to be included in the product.

There is no bright line test. Whether and the degree to which a company exercises influence over the manufacturing of a product through a contract will require a highly fact-intensive analysis. The

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Supplement. The OECD also adopted a Gold Supplement in July 2012 but has not yet incorporated that supplement into the OECD Due Diligence Guidance. The Gold Supplement is available online.

Adopting Release makes clear, however, that a company must have *some* actual influence over the manufacturing of the product in order to be covered by the rules.

While the question of influence over the manufacturing of a product will depend on the facts and circumstances, the Adopting Release states that a company should *not* be viewed as contracting to manufacture a product if it does no more than:

- specify or negotiate contractual terms that do not directly relate to the manufacturing of the product, such as training or technical support, price, insurance, indemnity, intellectual property rights, dispute resolution or similar terms, unless the company does so in such a way that it influences the manufacturing of the product in a manner practically equivalent to contracting on terms that directly relate to the manufacturing of the product;
- affix its brand, marks, logo or label to a generic product manufactured by a third party; or
- service, maintain or repair a product manufactured by a third party.

The SEC provides an illustration of how these principles should be applied -- the Adopting Release states that a service provider that specifies to a manufacturer that a cell phone it will purchase from the manufacturer to sell at retail must be able to function on a certain network does not in-and-of-itself exert sufficient influence to be viewed as contracting to manufacture the phone for purposes of the rules.

However, in a situation where a company's specification of performance standards would inevitably or naturally require the use of conflict minerals, even if the company does not specify that such conflict minerals be used, the company may be exerting a sufficient degree of influence over the content of the product such that it would be deemed to be "contracting to manufacture" the product.

Retailers generally should not be covered by the rules. However, retailers that exert sufficient influence over the manufacturing of products they sell by, for example, specifying the materials, parts, ingredients or components to be included in the product, may be covered by the rules if conflict minerals are necessary to the functionality or production of those products.

Is there leeway to determine that a conflict mineral that is intentionally added to a product is not "necessary to the functionality" of the product?

The Adopting Release lays out the following three, non-exclusive factors that companies should consider in determining whether a conflict mineral is necessary to the functionality of a product:

- whether a conflict mineral is contained in *and intentionally added* to the product or any component of the product and is not a naturally-occurring by-product;
- whether a conflict mineral is necessary to the product's *generally expected function, use, or purpose*; and
- if a conflict mineral is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration.

The Adopting Release states that *any* of these factors, either individually or in the aggregate, may be determinative as to whether conflict minerals are "necessary to the functionality" of a given product. These three factors are inter-related to some degree, as it will often be the case that a conscious decision to incorporate a specific mineral denotes the importance of that mineral to the product's generally expected function or use. The Adopting Release does seem to suggest that there is a presumption that a conflict mineral intentionally added to a product should be considered necessary to the functionality of that product, as the decision to add the mineral naturally begs the question of

why it was added. Still, the release's amorphous language should give companies some leeway to determine, in appropriate scenarios, that a conflict mineral that is intentionally added to a product might not be "necessary" to that product's generally expected function, use or purpose.

Regarding the third factor, the Adopting Release states that, where a conflict mineral is incorporated into a product for purposes of ornamentation, decoration, or embellishment, and the primary purpose of the product is *not* ornamentation or decoration, it is less likely to be "necessary to the functionality" of the product.

When is a conflict mineral "necessary to the production" of a product?

The rules do not define when a conflict mineral is necessary to the production of a product, but the Adopting Release states that a company should consider whether the conflict mineral is intentionally added in the product's production process, including the production process of any of the product's components, and whether the conflict mineral is necessary to produce the product. As noted above, however, the Adopting Release makes clear that *some* amount of conflict mineral must actually be contained in a product for the mineral to be considered necessary to the production of the product. Thus, a conflict mineral used in the production of a product, but not present in the product itself—such as a catalyst, no part of which remains in the final product—would not be considered necessary to the production of the product. The Adopting Release also clarifies that a physical tool or machine — such as a wrench, and indirect equipment — such as computers and power lines, used to produce a product are not covered by the rules, even if they contain conflict minerals and are necessary to the production of the product.

Must a company consider a product's packaging in determining whether the company is covered by the rules with respect to that product?

Yes, generally a company should take into account a product's packaging when determining whether the company might be covered by the rules. In thinking about a product's packaging, the company may wish to consider several threshold questions:

- Is it appropriate to consider the packaging as part and parcel of the "product," or is the packaging separate and distinct from the product? For example, a cardboard shipping box used to ship a product probably should not be considered part of the "product," but a tin can used to package food goods might be considered part of the "product."
- If the packaging contains conflict minerals, are those minerals "necessary to the functionality" of the product in question? For example, a can used for canned food might be viewed as necessary to the functionality of the canned food if the can has been chosen as the container for the food due to the attributes that it contributes to the combined product, including, for example, freshness, flavor, or its ability to preserve the food it contains.
- Is the conflict mineral used for ornamentation or decoration? If so, the Adopting Release suggests that the mineral would likely not be considered "necessary to the functionality" of the product, unless the primary purpose of the product in question is ornamentation or decoration.

How are R&D materials treated under the rules?

The Adopting Release provides that materials, prototypes, and other demonstration devices are not considered to be "products" covered by the rules, even if they contain conflict minerals. However, once an item is entered in the stream of commerce by being offered to third parties for consideration, it is deemed a "product" and potentially covered by the rules. This means that a

supplier of R&D prototypes or components containing conflict minerals that are necessary to the functionality of such items would be covered by the rules, if it sells such items to other companies.

STEP TWO – REASONABLE COUNTRY OF ORIGIN INQUIRY

If a company determines that it is covered by the rules, it must conduct, in good faith, a "reasonable country of origin inquiry" that is reasonably designed to determine if such conflict minerals originated in the covered countries or come from recycled or scrap sources.

Below are a number of questions that public companies may wish to consider when designing their reasonable country of origin inquiry.

Has the SEC provided any guidance on how companies should approach the reasonable country of origin inquiry?

Neither the rules nor the Adopting Release specifies the steps necessary to meet the reasonable country of origin inquiry requirement. This is because the SEC has said that it believes that the scope of the inquiry will depend on each company's particular facts and circumstances and may vary based on a company's size, products, relationships with suppliers, or other factors.

However, the SEC stated in the Adopting Release that it views an acceptable reasonable country of origin inquiry as one that follows the "supplier engagement" approach in the OECD Due Diligence Guidance. As its name suggests, this approach contemplates that companies will engage with the companies in their supply chain to make inquiries about the source of the conflict minerals and the smelters or refineries used to process the minerals. Broadly speaking, the OECD supplier engagement model encompasses a range of activities, such as communicating the company's sourcing policy and commitments to its suppliers, educating suppliers about the conflict minerals reporting obligation, and requesting and collecting information from suppliers regarding, for example, mineral content, the source of conflict minerals, the smelters or refineries used to process the minerals, and whether the conflict minerals come from recycled or scrap sources.

The OECD's Due Diligence Guidance also recognizes that companies may find it difficult to engage with upstream suppliers beyond their direct suppliers, and, in these circumstances, the OECD guidance encourages companies to cooperate with members in their industry with whom they share suppliers to identify the smelters or refineries in the supply chain. The guidance also suggests that a company can "push down" the reporting obligation so that its direct suppliers engage with their direct suppliers to gather the necessary information, and so on up the supply chain.

The OECD Due Diligence Guidance contemplates evolution and development of the due diligence process to take into account changes in circumstances, the development of traceability protocols, and emerging consensus regarding best practices. Companies are advised to monitor developments regarding the OECD's Due Diligence Guidance so that they can adapt their reasonable country of origin inquiries, as appropriate under the circumstances, to evolving standards.

What types of supplier representations can a company rely upon in conducting its reasonable country of origin inquiry?

As noted above, the rules and the Adopting Release do not specify the steps necessary to meet the reasonable country of origin inquiry requirement. The Adopting Release does, however, contain some guidance regarding the use of representations from suppliers that should be taken into account when structuring the reasonable country of origin inquiry. One noteworthy passage is as follows:

"we … view an issuer as satisfying the reasonable country of origin inquiry standard if it seeks and obtains reasonably reliable representations *indicating the facility at which its conflict minerals were processed* and demonstrating that those conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources. These representations could come either directly from that facility or indirectly through the issuer's immediate suppliers, but the issuer must have a reason to believe these representations are true given the facts and circumstances surrounding those representations." (emphasis added)

This suggests that the SEC expects that, in order to be relied upon, a supplier's representations must be based on something demonstrable regarding the source of origin of the minerals - e.g., being sourced from a certified "conflict free smelter." This passage also suggests, by contrast, that it might not be sufficient to rely solely on flat representations from suppliers that they do not use conflict minerals sourced from the DRC region.

In this regard, it is instructive that the OECD Due Diligence Guidance contemplates that, as part of the supplier engagement process, a company would inquire of its Tier 1 (direct) suppliers regarding the mineral content of the supplier's products or components, the names of smelters/refineries used in the supplier's chain of supply, and whether any minerals are from recycled or scrap sources. The OECD guidance suggests that each supplier will, in turn, elicit the same information from the lower-level suppliers up the chain.

Note also that the Electronic Industry Citizenship Coalition ("EICC") and the Global e-Sustainability Initiative ("GeSI") have developed a Conflict-Free Smelter Program through which they coordinate and oversee independent audits of smelters that process conflict minerals. EICC and GeSI are compiling lists of compliant tantalum, tin and tungsten smelters and gold refiners.[6] They also have developed a spreadsheet template for companies to use when gathering information from their supply chains.[7] These tools contemplate that companies will ascertain the identities of the smelters used to process the conflict minerals contained in the companies' products.

Because each company's inquiry must necessarily be tailored to its particular circumstances, in some situations a company might be able to meet the reasonable country of origin inquiry standard by getting representations only from its direct suppliers. While we tend to think this type of inquiry will normally not be sufficient, factors that could influence the determination about the adequacy of such an inquiry might include, among other things, the company's familiarity with, and the transparency of, the supply chain, the length of the supply chain, whether the direct suppliers have a substantial market presence and serve a large number of customers who will also be relying on the supplier's representations for conflict minerals reporting, and the absence of warning signs that might raise questions about the reliability of the supplier's representations.

Will a company's reasonable country of origin inquiry be sufficient if it does not receive responses from all of its suppliers?

The Adopting Release states clearly that a sufficient reasonable country of origin inquiry does not require a company to receive input from its entire supply chain, as long as the company's inquiry is reasonably designed and conducted in good faith, and the company does not ignore warning signs indicating that some of its conflict minerals may have originated in the covered countries.

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[6] The lists of compliant smelters and refiners are available online at http://www.conflictfreesmelter.org/cfshome.htm.

[7] The Conflict Minerals Reporting Template is available online at http://www.conflictfreesmelter.org/ConflictMineralsReportingTemplateDashboard.htm.

We don't think there should be any hard and fast standards about an acceptable level of response, with each company basing its determination on its unique facts and circumstances. Logically, however, there is likely to be a direct correlation between the response rate and the reasonableness of a company's inquiry into the origin of the conflict minerals in its products.

We also tend to think that a risk-based approach would be appropriate, under which a greater level of scrutiny would be applied to the smaller sub-set of suppliers with the largest concentration of products containing conflict minerals, with a lesser degree of scrutiny applied to other suppliers. Other criteria that might form a basis for such a risk-based approach include the volume of conflict minerals consumed by a supplier, and the relative strategic or financial importance of a supplier. Further, where one supplier accounts for a disproportionate volume of a particular conflict mineral, it would be prudent to ensure that a response is received from that supplier, even where the company has received responses from nearly all other suppliers.

To the extent that a company does not receive responses from all of its suppliers, it should not ignore warning signs indicating that some of its conflict minerals may have originated in the covered countries. The Adopting Release notes two examples of circumstances that, absent other information, should give a company reason to believe that its conflict minerals may have originated in the covered countries: (i) a company becomes aware that some of its conflict minerals were processed by smelters that sourced from many countries, including the covered countries, and the company is unable to determine whether the conflict minerals it received from such a "mixed smelter" were from the covered countries; and (ii) conflict minerals are claimed to originate from a country that has limited known reserves of the conflict mineral in question.

May a company's reasonable country of origin inquiry be informed by third parties, such as consultants?

Nothing in the rules or the Adopting Release rules out input from third parties, such as consultants, in the reasonable country of origin inquiry. But, because the SEC thinks an acceptable country of origin inquiry should be based on "supplier engagement," such input will be most useful when it supplements, rather than supplants, meaningful information gathered directly from suppliers.

If a consultant or other third party is used in this process, we think it is advisable for the company to work with the consultant to ensure that the company has a reasonable basis for relying on the consultant's conclusions and work product. For example, companies that use consultants may wish to request copies of documentary evidence supporting the consultant's work, so that the company can review the consultant's work itself and form a basis for relying on the conclusions. By contrast, a "black box" approach (where the company has no visibility into the consultant's work or underlying evidence) is likely not acceptable. In other words, we think the company should be able to exercise some independent judgment and have its own basis for drawing conclusions about the country of origin of the conflict minerals.

How are recycled or scrap metals treated under the rules?

If a company's reasonable country of origin inquiry permits the company to know, or reasonably believe, that the conflict minerals in its products came from recycled or scrap sources, the company need not exercise due diligence, or file a Conflict Minerals Report, with respect to such products. The rules also expressly permit companies to describe their products containing conflict minerals from recycled or scrap sources as "DRC conflict free."

For purposes of the rules, conflict minerals are considered to be from recycled or scrap sources if they are from recycled metals, which are reclaimed end-user or post-consumer products, or scrap

processed metals created during product manufacturing. Recycled metal includes excess, obsolete, defective and scrap metal materials that contain refined or processed metals that are appropriate to recycle in the production of tin, tantalum, tungsten and/or gold. Minerals partially processed, unprocessed or a "bi-product" from another ore are not included in the definition of recycled metal.

While the OECD's supplier engagement approach contemplates that companies will inquire of their suppliers regarding whether conflict minerals used in their products came from recycled or scrap sources, it is not clear whether, and to what extent, industry protocols such as the EICC/GeSI Conflict Free Smelter Program will provide companies and their suppliers with a reliable mechanism for verifying whether the conflict minerals in their products are from recycled or scrap sources.

What are some of the methods, tools and processes being used by companies to conduct their reasonable country of origin inquiry?

Listed below are some of the current methods, tools and processes we have heard companies may be using to conduct their reasonable country of origin inquiry. These will change over time as due diligence guidance, frameworks and resources evolve.

- Industry-wide protocols for gathering information from suppliers, such as the EICC and GeSI reporting template and certification tool. The EICC/GeSI reporting template is an Excel spreadsheet with a series of questions and data to be filled in. Reporting companies and/or suppliers in their chain send the reporting template to their lower-tier suppliers; the tool facilitates compilation of data.[8]
- Incorporating appropriate language in supplier contracts, and requiring suppliers to adopt or comply with customer's supply chain and sourcing policies.
- Requiring access to supplier documentation and records regarding their supply chains and sourcing, and requiring spot checks of suppliers.
- EICC/GeSI conflict-free smelter program. Under this program, most companies will be focusing on the supply chain from the company back to the smelter or refinery where the minerals were processed. This focus relies on the evolving EICC/GeSI conflict-free smelter program, which is an effort led by the electronics industry to verify the source of minerals processed at various smelters and refineries (using audits and other verification tools). Using this program, top-tier suppliers or companies at the end of the supply chain would be able to know, reliably, whether the smelters in their supply chain are "conflict-free." The OECD Due Diligence Guidance contemplates that, if these protocols work as intended, most companies would not need to engage with suppliers in the portion of the supply chain from the smelter or refiner back to the original mine of origin. To date, most progress has been made on the list of compliant tantalum smelters, while lists for tin and tungsten smelters are in process.[9]
- Collaborating/sharing data regarding supply chains with industry peers, and collaborating with peer and industry trade groups on best practices and diligence tools.
- Third party consultants. We understand that companies are considering using consultants to perform a variety of roles with regard to the reasonable country of origin and/or due diligence. These roles appear to range from advising on the design of an appropriate inquiry, assisting with the outreach to suppliers and collection of data, aggregating data from suppliers and making it available to multiple companies, and providing on-the-ground resources to assist with the actual

[8] The Conflict Minerals Reporting Template is available online.

[9] The lists of compliant smelters and refiners are available online.

due diligence. Companies using consultants to assist in, or even handle portions of, the inquiry should be comfortable that the work of the consultant gives the company an adequate basis for relying on the consultant's work and determinations. Further, the consultant's work should give the company evidence or other sufficient "output" to enable the company to have a basis for relying on the conclusions.

What content will be included in the Form SD for a company that determines, based on its reasonable country of origin inquiry, that it is not required to proceed to Step Three and file a Conflict Minerals Report?

A company will not be required to proceed to Step Three and file a Conflict Minerals Report if, based on its reasonable country of origin inquiry, it knows that the conflict minerals in its products did not originate (or does not have reason to believe may have originated) in the DRC region, or it knows or reasonably believes that such conflict minerals came from recycled or scrap sources.

For a company whose products contain conflict minerals, but which is not required to file a Conflict Minerals Report, the Form SD must describe, briefly, the company's reasonable country of origin inquiry and the resulting determination(s). This description must be included under a "Conflict Minerals Disclosure" heading, and the company must also disclose this information on its publicly available website, and provide a link to the website in the Form SD.

As for the content of the Form SD, the Adopting Release says that if a company has a supply chain policy, it would expect the Form SD to discuss it when describing its reasonable country of origin inquiry. It is likely that the content and level of detail in these Form SD's will evolve and vary widely in the first couple of years. Some companies may choose to provide an expansive discussion of the steps they took in their reasonable country of origin inquiry to demonstrate a "forward thinking" approach. To the extent a company relies on third parties, such as consultants, to assist in its inquiry, the Form SD would presumably need to describe the role played by such third parties. Over time, uniform descriptions of industry-wide protocols (e.g., conflict free smelter programs) are likely to emerge. It may be necessary to discuss specifically the steps followed if a company determines that its conflict minerals came from recycled or scrap sources. In addition, some companies may consider providing statistics on, for example, the number of suppliers engaged, response rate, etc., to help demonstrate the adequacy of their inquiry.

STEP THREE – SUPPLY CHAIN DUE DILIGENCE AND CONFLICT MINERALS REPORT

A company that knows, based on its reasonable country of origin inquiry, that the conflict minerals necessary to the functionality or production of its products did originate in the covered countries, or has reason to believe the conflict minerals may have originated in the covered countries, AND knows or has reason to believe the conflict minerals are not, or may not be, from recycled or scrap sources, must exercise due diligence on the source and chain of custody of such conflict minerals.

The rules require that a company's due diligence conform to a nationally or internationally recognized due diligence framework, if such a framework is available for the conflict mineral.[10] The Adopting Release states that the OECD Due Diligence Guidance satisfies the rules' criteria and may be used by companies as a framework to satisfy the rules' due diligence requirement.

[10] A "nationally or internationally recognized due diligence framework" must have been established following due-process procedures, including the broad distribution of the framework for public comment, and be consistent with the criteria standards in the Government Auditing Standards established by the Comptroller General of the United States. Item 1.01(d)(8) of Form SD.

Below are a number of questions that public companies may wish to consider when designing their due diligence inquiry and preparing their Conflict Minerals Report.

What are the objectives of the due diligence exercise?

The objectives of the due diligence exercise are to ascertain the origin and chain of custody of the conflict minerals, and whether the minerals financed or benefitted armed groups in the covered countries. As noted above, a company's due diligence must conform to a nationally or internationally recognized due diligence framework, if such a framework is available for the conflict mineral.

Also, in the case of conflict minerals that the company has reason to believe may not be from recycled or scrap sources, a further objective of the due diligence exercise is to determine whether the conflict minerals are from recycled or scrap sources. If a nationally or internationally recognized due diligence framework exists for a particular conflict mineral from recycled or scrap sources, a company must use that framework. The Adopting Release notes that the OECD gold supplement appears to be the only existing nationally or internationally recognized due diligence framework for a conflict mineral from recycled or scrap sources. Also, where no such nationally or internationally recognized due diligence framework exists for a particular conflict mineral from recycled or scrap sources, the final rules do not require an independent private sector audit.

What content must be included in the Conflict Minerals Report for a company that determines, based on its due diligence inquiry, that its conflict minerals did originate in the covered countries and are not from recycled or scrap sources?

The Conflict Minerals Report must include:

- a description of the measures taken by the company to exercise due diligence on the source and chain of custody of the conflict minerals;
  - The rules specify that the due diligence must include an independent private sector audit of the report.
- a statement that the company obtained an independent private sector audit of the report;
- with regard to any of the company's products manufactured or contracted to be manufactured that have not been found to be "DRC conflict free," a description of those products, the facilities used to process the conflict minerals in such products (which the SEC interprets to mean the smelter or refinery through which the minerals passed), the country of origin of those conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity;
  - "DRC conflict free" means the product does not contain conflict minerals that directly or indirectly financed or benefitted armed groups in the covered countries.
- the audit report prepared by the independent private sector auditor, as well as disclosure identifying the auditor (if the report itself does not identify the auditor).

What type of audit is acceptable?

The rules require a company to obtain an independent private sector audit of the Conflict Minerals Report, conducted in accordance with standards established by the Comptroller General of the United States. The Adopting Release notes that the staff of the Government Accountability Office (GAO), which is headed by the Comptroller General, has indicated that it does not intend to develop new standards for the independent private sector audit of the Conflict Minerals Report. Accordingly,

a company may choose from among existing GAO standards, such as the standards for attestation engagements or the standards for performance audits.

In this regard, note that the GAO standards for *attestation* engagements require that auditors be "licensed certified public accountants, persons working for a licensed certified public accounting firm or for a government auditing organization, or licensed accountants in states that have multi-class licensing systems that recognize licensed accountants other than certified public accountants." By contrast, the GAO standards for *performance* audits allow auditors other than certified public accountants to perform the audit.

The objective of the independent private sector audit is to express an opinion or conclusion as to (i) whether the design of the due diligence measures materially conforms with the criteria set forth in the nationally or internationally recognized due diligence framework used by the company, and (ii) whether the company actually performed the due diligence measures described in the Conflict Minerals Report. This audit objective is less comprehensive than that used in other contexts, and should be less demanding than an audit objective to determine, for example, whether the company's due diligence measures were effective.

The SEC has stated that it would not be inconsistent with the independence requirements in Rule 2-01 of Regulation S-X if the independent public accountant that audits a company's financial statements also performs the audit of the company's Conflict Minerals Report. However, the SEC cautioned that the engagement to audit a Conflict Minerals Report would be considered a "non-audit service" subject to the pre-approval requirements of Rule 2-01(c)(7) of Regulation S-X and that the fees related to the audit of the Conflict Minerals Report would need to be included in the "All Other Fees" category of the principal accountant fee disclosures. It is worth noting that proxy advisory firms such as Institutional Shareholder Services will scrutinize the level of non-audit services provided by the independent public accountant.

How does the transition period for reporting "DRC conflict undeterminable" work?

For calendar years 2013 and 2014 only (or calendar years 2013 - 2016 for smaller reporting companies), if a company conducts its due diligence inquiry but is unable to reach a conclusion from that inquiry as to whether its products containing conflict minerals are "DRC conflict free," it must still file a Conflict Minerals Report. However, such report will need to contain alternative disclosures, and the company may describe products containing such conflict minerals as "DRC conflict undeterminable." Further, in this case, an independent private sector audit is not required.

Among other factors, a company might base a "DRC conflict undeterminable" conclusion on being unable to determine whether its conflict minerals (i) originated in the covered countries (i.e., in cases where the conclusion obtained from the reasonable country of origin inquiry was only that the conflict minerals *may have* originated in the covered countries), (ii) came from recycled or scrap sources, or (iii) directly or indirectly financed or benefited armed groups in the covered countries.

Must a company filing a Conflict Minerals Report describe products that contain conflict minerals but which are "DRC conflict free"?

No. The only requirement is to describe products that are not determined to be DRC conflict free. Of course, a company may voluntarily include a discussion regarding other products, including those that contain conflict minerals but are determined to be DRC conflict free (and this may be especially pertinent for any products manufactured with conflict minerals sourced from the DRC region).

Form SD requires a company to make certain disclosures regarding conflict minerals (including, if applicable, its Conflict Minerals Report) on its publicly available Internet website. How long must such information be maintained on its website?

Although Form SD does not specify how long a company is required to maintain the applicable conflict mineral disclosures on its publicly available Internet website, the SEC staff has advised that companies may rely on the language in the Adopting Release which states that an issuer must make its conflict minerals disclosure or its Conflict Minerals Report available on its Internet website for one year.

OTHER TOPICS

Is there any exclusion under the rules for conflict minerals already in a company's supply chain?

Yes, there is a limited exclusion under the rules for any conflict minerals that have been smelted or fully refined, or are located outside the DRC region, prior to January 31, 2013. Thus, products that are fully manufactured before that date will not be covered by the rules. Partially manufactured products or components will not be covered by the rules if they contain conflict minerals that can be demonstrated either (i) to have been smelted or fully refined before January 31, 2013, or (ii) to be located outside the DRC region before January 31, 2013. This is also the case for stockpiles of conflict minerals in a company's supply chain, if the stockpiled minerals meet the foregoing conditions. Companies seeking to rely on this exclusion will need to consider what processes will be sufficient to demonstrate (or verify if called upon to do so) that their products meet these conditions.

Should companies be documenting their determinations under the rules?

Yes. We think companies should be documenting determinations as to whether or not they are covered by the rules (Step One), as well as the process followed in their reasonable country of origin inquiry (Step Two), if applicable.

Regarding Step One, a company's documentation would, presumably, include considerations regarding the various threshold questions under the rules, e.g., (i) whether certain items are "products," (ii) whether products contain conflict minerals, (iii) whether the company manufactures (or contracts to manufacture) a product, and (iv) whether a conflict mineral is necessary to the functionality of a product. While there are no regulatory standards to follow, the kinds of information that would logically be captured in appropriate documentation would include the factors considered in making rule coverage determinations, the weightings applied to such factors, any external guidance consulted, advice from third parties (if applicable), the parties (internal and external) involved in the analysis, and any documents or other materials reviewed. The documentation should cover both the substance (i.e. the factors considered and conclusions reached), as well as the process followed by the company. We think this will help evidence the company's good faith in reaching a determination about whether it is covered by the rules. This may be especially relevant if the company initially concludes it is not covered by the rules but later determines that it is.

Regarding Step Two, although the rules do not require it, we think companies should retain reviewable business records with respect to their reasonable country of origin inquiries. There are a number of reasons why companies should maintain records documenting their reasonable country of origin inquiry, including, for example:

- to help evidence compliance with the rules;

- as part of the company's internal control over financial reporting and/or disclosure controls and procedures, to provide support for determinations and conclusions made and disclosed;
- may be needed or useful as foundation for due diligence exercise, if required;
- may be needed for independent private sector audit; and
- OECD Due Diligence Guidance calls for retention of records for 5 years.

Will failure to file a required Form SD make a registrant ineligible to use Form S-3? Will a late Form SD cause a registrant to lose S-3 eligibility for 12 months?

Failure to file a required Form SD will make a registrant ineligible to use Form S-3 because Form SD is prescribed by Section 13(p) of the Exchange Act and Rule 13p-1 thereunder. General Instruction I(A)(3)(a) of Form S-3 requires the registrant to have filed all the material required to be filed pursuant to Section 13, 14 or 15(d) for a period of at least 12 months immediately preceding the filing of the Form S-3. Note that failure to file a required Form SD will also make the registrant an "ineligible issuer" under Securities Act Rule 405 and cause the public information requirement under Securities Act Rule 144(c) not to be satisfied.

However, we think a registrant should have its Form S-3 eligibility restored upon filing of the delinquent Form SD, based on an existing staff interpretation. (Note that General Instruction I(A)(3)(b) of Form S-3 generally requires the registrant to have filed "in a timely manner" all "reports" required to be filed during the 12 calendar months and any portion of a month immediately preceding the filing of the Form S-3.) In Securities Act Forms Compliance and Disclosure Interpretation 115.04, the staff interprets the "timely filed" requirement of General Instruction I(A)(3)(b) of Form S-3 to be limited to reports filed under Section 13(a) or Section 15(d) of the Exchange Act. Because Form SD is prescribed by Section 13(p), this staff interpretation should be able to be relied upon for the position that a late Form SD will not impair Form S-3 eligibility for 12 months. It will be important to review any applicable guidance offered by the SEC.

Are disclosures required in a company's quarterly reports on Form 10-Q or annual report on Form 10-K?

There is no line item requiring specifically requiring any disclosure regarding conflict minerals in 10-Q's or 10-K's. However, under some circumstances, some companies may decide to include disclosure. We think different companies will make different judgments about whether they should include any disclosures in their 10-Qs and/or 10-Ks regarding conflict minerals. The information could, conceivably, be relevant in the description of business, Management's Discussion and Analysis, or risk factors, for example. A company that anticipates difficulties complying with the rules, or that anticipates having to disclose that its products use conflict minerals sourced from the DRC region, could decide to add risk factor disclosure to its filings regarding these risks. In many cases, however, these issues will be unlikely to rise to a level of materiality such that disclosure would be required. But this will be something for each company to evaluate based on its own facts and circumstances.

Will the SEC review Form SD filings?

We do not know with certainty how the SEC will approach its review of Form SD filings, but we do expect that there will be some degree of review. In particular, it is not clear whether there will be an office or group within the Division of Corporation Finance that is charged with monitoring Form SD filings, or whether the SEC will rely on private groups bringing concerns with specific filings to the SEC's attention. To the extent the SEC staff comments on Form SD filings, we expect that comments, at least for an initial period, would concentrate on the adequacy of a company's

disclosures under the form requirements, possibly in light of contrary or other information about the company that is in the public domain. It is also possible that the SEC might question a company's failure to file a Form SD based on the company's determination that it is not covered by the rules.

Instruction 3 to item 1.01 of Form SD permits delayed reporting with respect to products manufactured or contracted to be manufactured by companies acquired by a registrant (or over which a registrant obtains control) during the last eight months of the year, if such company had not previously been obligated to provide a specialized disclosure report with respect to its conflict minerals. Does the language of this instruction also apply to businesses, divisions or operating units acquired through transactions that do not involve the acquisition of a stand-alone company, such as through an asset purchase?

The wording used in Instruction 3 to Item 1.01 of Form SD is "acquires .... a company," which, read literally, does not seem to encompass a business acquired through an asset purchase transaction. However, in our view the policy underlying the exception should apply whether the acquisition is structured as the acquisition of a stand-alone company or as an asset purchase. The staff might reasonably look to the internal control rules under Section 404 of Sarbanes-Oxley for guidance here. In that case, the staff has fashioned a delayed reporting period of up to one year for "businesses" purchased by a registrant.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our securities practice group:

Bruce Bennett	+1.212.841.1060	bbennett@cov.com
Bruce Deming	+1.415.591.7051	bdeming@cov.com
David Engvall (author)	+1.202.662.5307	dengvall@cov.com
Keir Gumbs	+1.202.662.5500	kgumbs@cov.com
David Martin (author)	+1.202.662.5128	dmartin@cov.com
Kristian Wiggert	+44.(0)20.7067.2280	kwiggert@cov.com

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Annex A
Source: Adopting Release.