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E-ALERT | Securities

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SEC STAFF ISSUES CONFLICT MINERALS FAQS

On May 30, 2013, the staff of the Securities and Exchange Commission (SEC) Division of Corporation Finance issued Frequently Asked Questions (FAQs) providing guidance on various aspects of the SEC's 2012 conflict minerals rulemaking.[1] The guidance reflects the staff's interpretation regarding a number of questions that have been raised under the rule, and, in some cases, applies general interpretive principles set forth in the Adopting Release. While not addressing all interpretive questions that have been raised by companies and other commentators, these new interpretations do provide valuable procedural and substantive guidance to companies grappling with the complexities of the SEC's conflict minerals rulemaking.

This e-alert summarizes the staff's informal guidance on these topics according to the three-step compliance process envisioned by the conflict minerals rules. The bulk of the staff's interpretations relate to the first step of this process, which requires public companies to determine whether they are subject to the rules based on their use of conflict minerals necessary to the functionality or production of products they manufacture or contract to have manufactured. The second step of the compliance process involves a reasonable country of origin inquiry, and the third step of the compliance process addresses the due diligence exercise and the related Conflict Minerals Report.

DETERMINING WHETHER A COMPANY IS COVERED BY THE RULES

Do the conflict minerals reporting rules apply to voluntary filers?

Yes. Rule 13p-1 requires all issuers that file periodic reports with the SEC under Exchange Act Sections 13(a) or 15(d), whether or not such issuers are required to file such reports, to file Form SD if conflict minerals are necessary to the functionality or production of a product the issuer manufactures or contracts to manufacture. The only exception to this requirement is for registered investment companies that are required to file periodic reports pursuant to Rule 30d-1 under the Investment Company Act of 1940. *Conflict Minerals FAQ No. 1*.

Do the conflict mineral rules apply to products manufactured by a consolidated subsidiary of an issuer?

Yes. Issuers must make all determinations required by the rules for products they manufacture (or contract to manufacture) themselves and for products manufactured (or contracted to be manufactured) by consolidated subsidiaries. This staff FAQ does not, however, address whether the rules cover the activities of other entities related to an issuer that might not be "subsidiaries," such as, for example, consolidated variable interest entities (VIEs). *Conflict Minerals FAQ No. 3*.

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[1] *See* Conflict Minerals, Rel. No. 34-67716 (Aug. 22, 2012) ("Adopting Release"). The Adopting Release is available on the SEC's website. For additional information regarding the Adopting Release and interpretive questions regarding the conflicts minerals rulemaking, respectively, see Covington Advisory: SEC Adopts Conflict Minerals Rules and Covington Advisory: Conflict Minerals Rules – Frequently Asked Questions.

Do the conflict mineral rules apply to packaging or containers manufactured or contracted to be manufactured by an issuer, where such packaging or containers are used to display, transport or sell a product the issuer manufactures or contracts to have manufactured?

No. The conflict minerals rules apply only to conflict minerals contained in the product and that are necessary to the functionality or production of the product itself. Packaging or containers used to display, transport or sell a product are not considered to be part of the product. This interpretation applies even where the package or container is necessary to preserve the functionality of the product until its first use, as is frequently the case with packaged food products and some pharmaceutical products. However, notwithstanding this interpretation, packaging and containers that are manufactured and sold alone, independent of another product, are themselves products subject to the conflict minerals rules. *Conflict Minerals FAQ No. 6*. This staff FAQ also leaves open to interpretation under the SEC's general guidance in the Adopting Release whether the rules apply to ancillary materials shipped or packaged with a product, such as user manuals, instructive CDs or similar materials.

Are issuers that manufacture equipment they use in providing a service they sell required to report on the conflict minerals contained in such equipment?

No. The staff takes the view that equipment manufactured (or contracted to be manufactured) by an issuer is not subject to the conflict mineral rules if such equipment is used by the issuer to provide services sold by the issuer. This position, however, is premised on one of the following conditions being met: (i) the equipment is retained by the service provider, (ii) the equipment is required to be returned to the service provider, or (iii) the equipment is intended to be abandoned by the customer following the terms of the service. While the staff FAQ gives as an example an issuer that operates a cruise line, the staff's interpretation should apply in other scenarios, such as, for example, a cable television provider whose customers use a cable set-top box to receive programming. *Conflict Minerals FAQ No. 7*.

Are tools, machines or other equipment that an issuer manufactures or contracts to have manufactured for it to use in the manufacture of its products subject to the conflict minerals reporting requirements? Do they become subject to the rules if the issuer sells them after using them?

No. Tools, machines and other equipment are not products of an issuer if they are manufactured or purchased for use in the manufacture of the issuer's products. The staff also confirms that the issuer's later sale of those tools, machines or other equipment following their use would not transform them into products subject to the conflict minerals reporting requirements. *Conflict Minerals FAQ No. 8*.

If an issuer specifies that its logo be etched into a generic product manufactured by a third party, would the issuer be deemed to be "contracting to manufacture" the product?

No. Etching or otherwise marking a generic product manufactured by a third party with a logo, serial number or other identifier is not considered to be "contracting to manufacture" the product. In this regard, the Adopting Release notes that an issuer shall not be considered to be contracting to manufacture a generic product if its actions are limited to affixing its brand, marks, logo or label to a generic product manufactured by a third party. *Conflict Minerals FAQ No. 4*.

Are all activities customarily associated with mining excluded from the concept of manufacturing?

Yes. Issuers engaged only in mining activities, or activities customarily associated with mining, are not considered to be manufacturing conflict minerals. The staff FAQ indicates that this guidance

includes the processing stages involved in gold mining of lower grade ore. *Conflict Minerals FAQ No. 2*.

When does an issuer become subject to conflict minerals reporting requirements following its initial public offering?

The staff will not object if an issuer commences conflict minerals reporting for the first reporting calendar year that begins no sooner than eight months after the effective date of the registration statement for its initial public offering. *Conflict Minerals FAQ No. 11*. This interpretation extends Instruction 3 to Item 1.01 of Form SD, which provides a corresponding grace period for issuers that acquire or otherwise obtain control over a company that had not previously been subject to the conflict minerals rules. The staff FAQ leaves unsettled the question of when the conflict minerals rules begin to apply to a company that becomes subject to Exchange Act reporting requirements following a spin-off.

REASONABLE COUNTRY OF ORIGIN INQUIRY

Must an issuer conduct a reasonable country of origin inquiry regarding a conflict mineral contained in a generic component included in a product of the issuer?

Yes. An issuer must conduct a reasonable country of origin inquiry with respect to conflict minerals contained in generic components included in the products it manufactures or contracts to manufacture. The staff makes clear that there is no distinction between components of a product that an issuer directly manufactures, or contracts to manufacture, and generic ones that it purchases to include in a product. *Conflict Minerals FAQ No. 5*.

CONFLICT MINERALS REPORTS

What disclosure must an issuer provide in its Conflict Minerals Report if it determines that products it manufactures or contracts to have manufactured are not found to be DRC conflict free or are DRC conflict undeterminable?

An issuer required to file a Conflict Minerals Report with its Form SD must unequivocally state that its products "have not been found to be 'DRC conflict free'" or are "DRC conflict undeterminable," as applicable. The description of such products required by Item 1.01(c)(2) of Form SD should be based on the facts and circumstances and use terms commonly understood within the issuer's industry. Issuers are not required to describe products using model numbers. *Conflict Minerals FAQ No. 9*.

What reporting obligations apply when an issuer determines that products it manufactures or contracts to have manufactured are DRC conflict free?

An issuer that determines its products contain conflict minerals from the Democratic Republic of the Congo or an adjoining country is required to file a Conflict Minerals Report with its Form SD and obtain an independent private sector audit of the Conflict Minerals Report, even if it determines that its products are DRC conflict free. However, an issuer reaching a determination that its products are DRC conflict free need not disclose in its Conflict Minerals Report the products containing those conflict minerals or provide the other disclosures required by Item 1.01(c)(2) of Form SD. *Conflict Minerals FAQ No. 10*.

OTHER - FORM S-3 ELIGIBILITY

Does failure to file Form SD in a timely manner cause an issuer to lose eligibility to use Form S-3?

No. The staff takes the view that the timeliness condition for eligibility to use Form S-3 relates only to periodic reports filed under Exchange Act Sections 13(a) or 15(d) or materials filed under Exchange Act Sections 14(a) and 14(c). As Form SD is required to be filed under Section 13(p) of the Exchange Act, it is not subject to the timeliness requirements of Form S-3. *Conflict Minerals FAQ No. 12*; *see also Securities Act Forms Compliance and Disclosure Interpretation No. 115.04*.

However, neither this interpretation nor the Compliance and Disclosure Interpretation on which it is premised address the condition to Form S-3 eligibility that an issuer be a current filer by having filed "all the material required to be filed pursuant to Section 13, 14 or 15(d)" for the 12 months preceding the filing of a registration statement on Form S-3. Accordingly, without further clarification from the staff it is doubtful that an issuer could use Form S-3 when it has failed to file one or more required reports on Form SD.

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

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