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CONFLICT MINERALS REPORTING DEADLINE NEARS: UPDATE AND FREQUENTLY ASKED QUESTIONS

The first specialized disclosure reports on Form SD and, if required, accompanying Conflict Minerals Reports, are due by May 31, 2014. Form SD is required to be filed by any company that files reports with the SEC under the Securities Exchange Act of 1934 (the "Exchange Act") and manufactures (or contracts to manufacture) products containing conflict minerals, generally tantulum, tin, tungsten and gold.[1] Form SD must briefly describe the process followed by the company to determine whether the conflict minerals in the company's products were sourced from the Democratic Republic of the Congo ("DRC") or adjoining countries or came from recycled or scrap sources. In addition, if the company is required under the SEC's rules to conduct a due diligence exercise because it knows or has reason to believe its conflict minerals originated in the DRC or adjoining countries and are not from recycled or scrap sources, it must file a Conflict Minerals Report with the Form SD. The initial Form SD (and, if applicable, Conflict Minerals Report) are to cover products manufactured during 2013.

This advisory briefly summarizes the key elements of the SEC's conflict minerals rules, discusses some recent developments, and answers a number of frequently asked questions.

THE SEC'S CONFLICT MINERALS RULES

The SEC's conflict minerals rules[2] require companies to disclose information annually about their use of conflict minerals originating and financing armed groups in the DRC or an adjoining country. Because conflict minerals are used in manufacturing a wide array of products, such as smartphones, cameras, computers, microchips, automobiles, tools and heavy machinery, the conflict minerals rules impact many public companies.

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

1. A company must determine whether it is covered by the rules based on its use of conflict minerals. Generally, the rules cover public companies that manufacture, or contract to manufacture, products containing conflict minerals that are necessary to the functionality or production of such products.

2. A company that is covered by the rules must conduct a "reasonable country of origin inquiry" designed to determine if the conflict minerals in its products originated in the DRC or an

[1] More specifically, under the SEC's rules "conflict mineral" means columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives, which are limited to tantulum, tin and tungsten. *See* item 1.01(d)(3) of Form SD.

[2] The SEC adopted the conflict minerals rules under Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") on August 22, 2012. *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.

adjoining country or are from recycled or scrap sources, and must file a Form SD to describe this inquiry.

3. A covered company that determines or believes, based on its reasonable country of origin inquiry, that its conflict minerals originated in the DRC or an adjoining country and did not come from recycled or scrap sources, must exercise "due diligence" on the source and chain of custody of its conflict minerals. As noted above, depending on the results of its due diligence, the company may also need to file a Conflict Minerals Report with its Form SD containing specified disclosures regarding its due diligence and products not found to be DRC conflict free. The specific disclosure required to be included in the Conflict Minerals Report depends on whether the product is determined to be DRC conflict free, DRC conflict undeterminable, or "not found to be DRC conflict free."[3]

RECENT DEVELOPMENTS

Legal Challenge to Rules

Shortly after the SEC adopted the conflict minerals rules, a coalition of business organizations filed suit contending that the SEC exceeded its statutory mandate under both the Dodd-Frank Act and the Administrative Procedure Act, and that the rules infringe the First Amendment by improperly compelling speech.[4] After the U.S. District Court granted the SEC's motion for summary judgment on July 23, 2013,[5] the plaintiffs appealed to the U.S. Court of Appeals for the District of Columbia Circuit.

On January 7, 2014, the Court of Appeals heard oral argument in the case. News reports have indicated that two of the three judges on the panel voiced skepticism over both the SEC's authority to adopt the rules in the form adopted and the rules' constitutionality.[6] It is not clear whether the Court of Appeals will issue its opinion prior to the May 31, 2014 reporting deadline. Although the disposition of the case and the fate of the conflict minerals rules as currently written are in doubt, for the time being the conflict minerals rules remain in place, and, therefore, public companies are well-advised to proceed in their compliance efforts.

Form SD Posted by SEC

The SEC recently posted on its website a Form SD to be used by reporting companies.

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[3] The term "DRC conflict free" means the product does not contain conflict minerals necessary to the functionality or production of that product that finance or benefit armed groups in the DRC or an adjoining country. The term "DRC conflict undeterminable" means that the company is unable to determine, after exercising due diligence, whether or not the product qualifies as DRC conflict free. See item 1.01(d)(4) and (5) of Form SD.

[4] The suit was originally filed in the U.S. Court of Appeals for the District of Columbia Circuit, then removed to the U.S. District Court after a ruling in a different case under the Dodd-Frank Act held that the U.S. District Court was the proper venue for direct challenges to SEC rules such as these.

[5] Nat'l Ass'n of Manufacturers v. SEC, 2013 WL 3803918, No. 13-cv-635 (D.D.C. July 23, 2013).

[6] *See, e.g.*, Andrew Ackerman, *Appeals Court Expresses Doubts About SEC Rule on Conflict Minerals*, WALL ST. J., Jan. 7, 2014, http://online.wsj.com/news/articles/SB10001424052702304617404579306772047974880; Sarah N. Lynch, *Judges Challenge U.S. SEC over 'Conflict Minerals' Rule*, REUTERS, Jan. 7, 2014, http://www.reuters.com/article/2014/01/07/usa-sec-conflictminerals-idUSL2N0KD1CF20140107.

FREQUENTLY ASKED QUESTIONS

Below are answers to a number of frequently asked questions concerning the conflict minerals rules and Form SD.

What due diligence standards satisfy the rules' requirement?

If a company's reasonable country of origin inquiry requires the company to proceed to a due diligence inquiry, the rules require that the due diligence conform to a nationally or internationally recognized due diligence framework designed to ascertain the origin and chain of custody of the conflict minerals and whether the conflict minerals are from recycled or scrap sources, if such a framework is available for the conflict minerals at issue.[7] The Adopting Release states that the due diligence guidance published by the Organization for Economic Cooperation and Development[8] satisfies the rules' criteria and may be used by companies as a framework to satisfy the due diligence requirement. If a company's due diligence inquiry requires the company to file a Conflict Minerals Report, the 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 OECD Guidance is a set of voluntary guidelines to assist companies in conducting supply chain due diligence on gold, tantalum, tin and tungsten sourced from conflict-affected or high-risk areas. It provides specified recommendations to companies depending on their position in the mineral supply chain (i.e. upstream - from the smelter to the mine of origin, or downstream - from the smelter to the finished product). A number of industry-led initiatives have evolved to help promote transparency of the conflict minerals supply chain, and to assist companies in implementing the OECD Guidance. These initiatives provide tools for downstream companies (i.e. companies manufacturing finished products or components used in such products) to implement the OECD Guidance. Such tools include:

- A standard conflict minerals reporting template and dashboard tool that companies may use to survey their suppliers. Created by the Electronic Industry Citizenship Coalition and the Global e-Sustainability Initiative, the reporting template is meant to be distributed by the SEC-reporting company to its first tier suppliers, who, in turn, distribute the reporting template to their suppliers, and so on up the supply chain.
- The Conflict-Free Smelter (CFS) program, which is intended to accomplish "upstream" due diligence on behalf of downstream companies. Under the program, tin, tantalum and tungsten smelters, and gold refiners, are audited in accordance with auditing standards contemplated by the OECD Guidance to determine whether the smelter follows procedures designed to ensure that the minerals processed at the smelter do not finance or benefit armed groups in the DRC region. Smelters found to be compliant are listed on the Conflict-Free Smelter list maintained on the website sponsored by the CFS program. Downstream companies can rely on these lists to fulfill their reasonable country of origin inquiry and/or due diligence obligations, provided they are able to confirm the smelters through which the conflict minerals in their products passed.

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[7] 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.

[8] OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (2d ed.) (2013) ("OECD Guidance").

If a company is required to conduct an independent private sector audit of its due diligence process, what standards must that audit meet?

If a company must file a Conflict Minerals Report, the conflict minerals rules generally require a company to obtain an independent private sector audit of the report conducted in accordance with standards established by the Comptroller General of the United States (as noted below, the audit is not required for reports filed in 2014 and 2015 for products that are DRC conflict undeterminable). Because the Government Accountability Office (GAO), which is headed by the Comptroller General, has not developed new standards for this audit, a company may choose from among existing GAO standards, such as the standards for attestation engagements or performance audits.

The objective of the independent private sector audit is to express an opinion or conclusion as to whether the design of the due diligence inquiry materially conforms with the criteria set forth in the nationally or internationally recognized due diligence framework used by the company, and 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.

To assist companies and auditing firms conducting an independent private sector audit under the conflict minerals rules, the American Institute of CPAs has published guidance and a set of questions and answers regarding the scope and process of the independent private sector audit.[9]

Do the conflict minerals rules require a third-party audit for a product that is "DRC conflict undeterminable"?

No. For products manufactured in 2013 and 2014 only (and also in 2015 and 2016 in the case of smaller reporting companies), no independent private sector audit is required with respect to conflict minerals in any products classified by a company as "DRC conflict undeterminable."[10] The audit is, however, required with respect to any products classified as either "DRC conflict free" or "not found to be DRC conflict free."

Under what circumstances could a product be classified as "DRC conflict undeterminable"?

A company may classify a product as "DRC conflict undeterminable" if, after the completion of due diligence, the company is unable to determine the source and chain of custody of the conflict minerals in the product (including whether or not such conflict minerals came from the DRC or an adjoining country), or whether the conflict minerals in the product financed or benefitted armed groups in that region. The "undeterminable" classification is available only for reports filed in 2014 and 2015 (and, in the case of smaller reporting companies, 2016 and 2017). After such time, any products with a conflict undeterminable status would need to be classified as "not found to be DRC conflict free."

How should a product be classified when it contains a mix of minerals or components with different conflict characteristics (i.e., "DRC conflict free," "DRC conflict undeterminable" and/or "not found to be DRC conflict free")?

If a company determines through its due diligence exercise that ***any*** of the conflict minerals in a product came from the DRC or an adjoining country and that such minerals financed or benefitted

[9] The AICPA guidance is available on its website, http://www.aicpa.org/interestareas/frc/pages/aicpaconflictmineralsresources.aspx.
[10] See Instruction 2 to item 1.01 of Form SD; Adopting Release at 186-187.

armed groups there, the company would be required to classify the product as "not found to be DRC conflict free," and would not be able to classify it as "DRC conflict undeterminable."

Where some of the conflict minerals in a product have been determined to be "DRC conflict free" (for example, because they did not originate in the DRC or an adjoining country or were processed at a Conflict Free Smelter), but the product also contains other conflict minerals with an undeterminable status, the product may be classified as "DRC conflict undeterminable." This is the case because the product as a whole may (depending on the eventual outcome of due diligence) be shown to contain some conflict minerals that came from the DRC or an adjoining country and that financed or benefitted armed groups there.

May a Conflict Minerals Report discuss products by category or group, rather than on a product-by-product basis?

The SEC has indicated that a company should describe its products not found to be "DRC conflict free" or that are "DRC conflict undeterminable" "in terms commonly understood within its industry."[11] While the text of the rules uses the term "products," in the proposing release for the rules the SEC said that the description should sufficiently identify the "products or categories of products." Also in this context, the SEC has indicated that each company is best positioned to describe its own products based on its own facts and circumstances, and that the product description need not include model or serial numbers. Accordingly, absent future SEC or staff guidance to the contrary, we believe it is reasonable for a company to describe its products individually or by category or group, so long as the description reasonably enables readers to understand the range of products covered.[12]

How much detail should a company include in its "brief" description of its "reasonable country of origin inquiry" in Form SD?

Although the SEC has not provided much guidance on this point, the Adopting Release indicates that the SEC would expect a company to describe its supply chain policy, if it has one. We expect that the detail provided by each company in its Form SD regarding its reasonable country of origin inquiry will vary according to the company's own facts and circumstances. A company should describe the process it used to determine that the conflict minerals contained within its manufactured products did not originate from covered countries and/or came from recycled or scrap sources, including whether the company relied on third parties or followed common industry protocols for determining the sources of its conflict minerals, such as the Conflict-Free Smelter program.

Must a company filing a Conflict Minerals Report identify or otherwise describe its products that have been determined by a due diligence inquiry to be "DRC conflict free"?

No. A company need only describe products that are "not determined to be DRC conflict free" in its Conflict Minerals Report. Of course, a company may voluntarily discuss other products as well, including those containing conflict minerals but found to be "DRC conflict free."

Who should sign the Form SD?

The Form SD should be signed by an executive officer of the company. The term "executive officer" is defined in Rule 3b-7 under the Exchange Act and means a company's president, any vice

[11] "Dodd-Frank Wall Street Reform and Consumer Protection Act Frequently Asked Questions: Conflict Minerals," http://www.sec.gov/divisions/corpfin/guidance/conflictminerals-faq.htm ("Conflict Minerals FAQs").
[12] It is also worth noting that the EICC/GeSI reporting template described above contemplates that suppliers may, if they elect, report on product categories instead of individual products.

president in charge of a principal business unit, division or function, any other officer who performs a policy-making function, and any other person who performs similar policy-making functions for the company. The requirement that an executive officer sign the form is slightly different from the signature requirements of other reports under the Exchange Act, such as those for annual reports on Form 10-K (which require signature by specified officers and a majority of the board of directors) and reports on Form 8-K (which require signature by a person duly authorized by the company to sign the report).

Should the Form SD be covered by a company's disclosure controls and procedures?

Yes, the Form SD is a report filed under the Exchange Act, and, as such, should be covered by a company's disclosure controls and procedures. This may mean, for example, that the Form SD should be reviewed by a company's disclosure committee, if it has one. Companies may also wish to prepare backup documentation evidencing the process followed in conducting the reasonable country of origin inquiry and, if applicable, due diligence, in conjunction with preparing the required disclosures. These processes should be tailored to the unique characteristics of the information called for by Form SD, and need not be the same as those followed for other Exchange Act reports. Companies should review, and update as necessary, their disclosure controls and procedures to incorporate the procedures to be followed with respect to Form SD.

If a company sells a business unit manufacturing products containing conflict minerals in a calendar year, must the selling company cover those products in its Conflict Minerals Report for that year?

Although the SEC has not provided guidance on this point, we believe the most prudent course would be for the selling company to cover those products manufactured by the sold business unit for the portion of the calendar year in which the company owned the business unit.

What records should a company reporting under the conflict minerals rules retain?

The SEC has not put forth regulatory standards for the records a company reporting under the conflict minerals rules should retain. However, we recommend that companies retain records documenting both the process and substance of how they determined they are (or are not) covered by the conflict minerals rules, and, if necessary, how they performed their reasonable country of origin and due diligence inquiries. Adequate records should include, at a minimum, the parties involved in making coverage determinations and performing any necessary inquiries (including whether the company sought external guidance), the documents and other materials reviewed, the factors the company considered in making determinations (including how the company weighed those factors), and the conclusions reached. Companies should consider that maintaining adequate records will help demonstrate compliance with the conflict minerals rules, in addition to facilitating later inquiries and independent private sector audits, if necessary.

For how long must a company maintain disclosures required by the conflict minerals rules on its website?

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

Will failure to file a timely Form SD cause a company to lose Form S-3 eligibility?

No. The SEC's position is that the timeliness condition for eligibility to use Form S-3 relates only to periodic reports filed under Sections 13(a) or 15(d) of the Exchange Act or materials filed under Exchange Act Sections 14(a) and 14(c). As Form SD is filed under Section 13(p) of the Exchange Act, it is not subject to the timeliness requirements of Form S-3.[13]

Will failure to file a Form SD at all cause a company to lose Form S-3 eligibility?

Probably. The SEC's interpretive guidance does not 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 before filing a registration statement on Form S-3. Accordingly, without further SEC clarification, it is doubtful that a company could use Form S-3 when it has failed to file one or more required reports on Form SD.

Should a company include disclosures regarding conflict minerals in its annual report on Form 10-K?

Maybe. There is no line item specifically requiring a company to make disclosures regarding conflict minerals in its annual reports on Form 10-K or quarterly reports on Form 10-Q. However, some companies may decide to disclose such information, for example, where it anticipates difficulties complying with the rules or having to disclose that its products use conflict minerals sourced from the DRC region. Information regarding conflict minerals could potentially be relevant in a company's business description, risk factors, or management's discussion and analysis of financial condition and results of operations. In many cases, however, these issues will be unlikely to rise to a level of materiality such that disclosure would be required. Each company must evaluate whether disclosures regarding conflict minerals are required in its periodic reports based on its own circumstances.

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

Eric Blanchard	+1.212.841.1111	eblanchard@cov.com
David Engvall (co-author)	+1.202.662.5307	dengvall@cov.com
Keir Gumbs (co-author)	+1.202.662.5500	kgumbs@cov.com
David Martin	+1.202.662.5128	dmartin@cov.com
Alex Kaplan (co-author)	+1.202.662.5869	akaplan@cov.com

[13] See Conflict Minerals FAQs.