SEC Proposes Disclosure Rules Regarding the Use of Conflict Minerals

In December 2010, the Securities and Exchange Commission proposed rules to implement Section 1502 of Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires SEC reporting companies to disclose whether they use "conflict minerals" in their products. "Conflict minerals" are defined to include gold, cassiterite, columbite-tantalite (coltan), wolframite and their derivatives (including tin, tantalum and tungsten), and any other minerals or derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or its adjoining countries (the "Designated Countries").

The effects of the proposed rules are expected to be far-reaching because conflict minerals are used widely in a variety of industries. The minerals covered by the proposed rules are used to make jewelry, components of automobiles, light bulbs, turbine engines for aircraft and energy generation, filaments in various electronic components, solder for joining electronic components together, condensers and micro-electronic technology (chips and processors), cell phones, nuclear reactors and various other electronic components. Moreover, even though the proposed rules will require disclosure by reporting companies, because these companies will need to look into their supply chains for possible sources of conflict minerals, the proposed rules can have considerable impact on non-reporting companies as well.

Final rules are expected to be adopted by the SEC by December 2011.

Scope

The proposed rules apply to companies that file reports with the SEC pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This includes all U.S. domestic companies that file annual reports on Form 10-K, all Canadian companies that file annual reports on Form 40-F, and all foreign private issuers that file annual reports on Form 20-F. Foreign private issuers that are exempt from Exchange Act registration under Exchange Act Rule 12g3-2(b) are not subject to the rules.

Companies Subject to the Proposed Rules

The proposed rules apply to companies that manufacture their own products or contract others to manufacture their products and for which conflict minerals are necessary to the functionality or production of their products.

Manufacture or Contract to Manufacture Products. The proposed rules apply to any reporting company that (i) manufactures its products, (ii) contracts with others to manufacture its products and has influence regarding the manufacturing of those products or (iii) sells generic products under its own brand name (or a separate brand name that it has established) and contracts with others to manufacture products specifically for it, regardless of whether it has any influence over the manufacturing specifications of those products. The rules do not apply to retailers that sell only third-party products if they have no contract or other involvement regarding the manufacturing of those products, or if those retailers do not sell

those products under their brand name (or a separate brand they have established) and do not have those products manufactured specifically for them.

Necessary to the Functionality or Production of a Product. The determination of whether a conflict mineral is "necessary" for a product is required to be made without regard to the amount of conflict minerals used in the product. In addition, a conflict mineral will be considered necessary for a product if a company intentionally includes the conflict mineral in its product's production process and the mineral is necessary to that process, even if the mineral is ultimately not included in the final product. A company will not be subject to the rules if the only conflict minerals necessary to the production of its products are those used in a physical tool or a machine used to produce its products. For example, an automobile manufacturer that uses no conflict minerals in its products would not become subject to the proposed rule if in the production of its automobiles it uses an instrument that contains conflict minerals.

Country of Origin Inquiry

Companies subject to the rules are required to make a "reasonable country of origin inquiry" as to whether the conflict minerals used in their products originated in one of the Designated Countries. In the proposing release, the SEC indicated that the nature of such an inquiry will be dependant on a particular company's facts and circumstances and that it expects that the facts and circumstances surrounding what constitutes a reasonable country of origin inquiry will change as the information systems in place to discover the use of conflict minerals improves. The proposing release suggests that a company may satisfy this inquiry requirement by receiving reasonably reliable representations regarding the origins of its conflict minerals from the facility at which its conflict minerals are processed.

Disclosure Requirements

If a company determines that the conflict minerals associated with its products ***did not originate*** in a Designated Country, it must:

- disclose in its annual report and on its website its conclusion and provide a brief description of the reasonable country of origin inquiry it undertook;
- disclose in its annual report the internet address of its website where this disclosure will be maintained;
- maintain this disclosure on its website until it files its next annual report; and
- maintain the business records necessary to support its conclusion.

It is **not** required to furnish a conflict mineral report (described below) if the conflict minerals do not originate in a Designated Country.

If a company determines that the conflict minerals associated with its products ***did originate*** in a Designated Country, or if the company is unable to reasonably determine that its conflict minerals did not originate in a Designated Country, it must:

- disclose its conclusion in its annual report and on its website;
- furnish a conflict mineral report (the contents of which are described in greater detail below) as an exhibit to its annual report;
- post the conflict minerals report on its website and disclose in its annual report the availability of such report on its website and the internet address of its website; and
- maintain the conflict minerals report and related disclosure on its website until it files its next annual report.

Conflict Mineral Reports

Companies that use conflict minerals from Designated Countries are required to prepare conflict mineral reports. A conflict mineral report must contain a description of the measures taken by a reporting company to exercise "due diligence" in determining the source and chain of custody of the conflict minerals associated with its products. The SEC did not prescribe a particular standard for the due diligence process, but noted that a company's conformity with nationally or internationally recognized standards of due diligence for determining the supply and chain of custody of conflict minerals will serve as evidence that the determination was made after due diligence. The Organization for Economic Cooperation and Development (the "OECD")[1] has adopted guidance on due diligence. The U.S. State Department, which is responsible for providing guidance on how to conduct supply chain due diligence to prevent the financing of armed conflicts or human rights violations, has endorsed the guidance issued by the OECD when establishing supply chain due diligence practices.

The proposed rules require reporting companies to obtain independent private sector audits of their conflict mineral reports, which must be conducted in accordance with the standards established by the Comptroller General of the United States. The staff of the Government Accountability Office ("GAO") has suggested that no new standards need to be promulgated and that certain auditing standards currently part of the Government Auditing Standards will be applicable. However, there are still uncertainties regarding audit standards, including the criteria to be used in the audit, the sufficiency of evidence to support the assertions in the report and the specific opinion to be expressed and audit firms have requested that the SEC clarify these points in the final rules. A copy of the audit must be included with the conflict mineral report.

A conflict mineral report must contain a description of the products of the reporting company that are not "DRC conflict free." "DRC conflict free" is defined as a product that does not contain conflict minerals that directly or indirectly finance or benefit armed groups in the Designated Countries. In addition, each conflict mineral report must disclose the country of origin of those minerals that are contained in products that are not DRC conflict free, the facilities used to process such minerals and the efforts of the reporting company to determine the mine or location of origin of such minerals with the greatest possible level of specificity.

[1] OECD Guidance can be found at: http://www.oecd.org/dataoecd/62/30/46740847.pdf. The OECD is reviewing and refining this guidance, which is expected to be completed in June 2012.

With respect to conflict minerals from recycled and scrap sources, the SEC recognized the difficulty of looking through the recycling or scrap process and generally did not expect reporting companies to know the origins of their recycled or scrap conflict minerals. Companies using recycled or scrap conflict minerals are required to furnish a conflict mineral report, but they may presumptively consider these conflict minerals to be DRC conflict free. In addition, companies are required to disclose in their annual reports that their conflict minerals were obtained from recycled or scrap sources and that they furnished a conflict minerals report regarding those recycled or scrap minerals.

The conflict minerals report will be furnished to the SEC as an exhibit to the reporting company's annual report, but will not be considered "filed" with the SEC. As a result, reporting companies would not be exposed to liability under Section 18 of the Exchange Act for misrepresentations in the conflict minerals report, as they would if the report were included in the body of the annual report or were incorporated by reference into that report. However, misrepresentations in a conflict minerals report may still expose reporting companies to liability under the general reporting requirements of Section 13(a) and 15(d) of the Exchange Act. Moreover, because the report is not filed, the independent private sector auditor would not assume expert liability for the representations made in the report.

Timing of Implementation

The proposed rules would require reporting companies to provide their first conflict minerals disclosure after the first full fiscal year following promulgation of the final rules.

The date that a reporting company takes possession of conflict minerals determines the reporting year in which it would report those minerals. For example, if a manufacturer of cell phones receives a shipment of coltan on December 31, 2012, the final day of its fiscal year, it would have to include information about that coltan shipment in its annual report for 2012. However, if it receives the shipment of coltan on January 1, 2013, it would include information about the coltan shipment in its annual report for 2013.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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