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The Dodd-Frank Act's Requirements Relating to Conflict Minerals and Mining and Resource Extraction Companies

A little noticed provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") directs the U.S. Securities and Exchange Commission (the "SEC") to promulgate new rules for SEC reporting companies (both domestic and foreign) that use "conflict minerals" originating in the Democratic Republic of Congo ("DRC") or adjoining countries. The Act also imposes new rules on SEC reporting companies engaged in mining operations and directs the SEC to promulgate new rules for SEC reporting companies engaged in oil, natural gas and mineral extraction activities.

Conflict Minerals

Scope. In an attempt to address the violent conflict in the DRC, Section 1502 of the Act directs the SEC to promulgate new disclosure rules for SEC reporting companies for whom "conflict minerals are necessary to the functionality or production of a product manufactured by such persons." The new disclosure rules are to include submission of annual disclosure to the SEC and a more detailed report that will be subject to audit. The SEC is required to promulgate rules to implement these disclosure requirements by April 17, 2011.

If the SEC adopts the broadest possible interpretation of Section 1502 of the Act, then SEC reporting companies in a multitude of industries would be subject to these requirements because so-called "conflict minerals" are used widely. In addition, whether a product manufactured by a subsidiary of a reporting company would trigger the new disclosure requirements will need clarification. Also, it appears that there is no test to determine when a conflict mineral is "necessary to the functionality or production" of a manufactured product. The terms "manufacture", "product" and "derivatives" are not specifically defined. Theoretically, any company that incorporates conflict minerals in its products or in its production processes, or any company that sells or processes conflict minerals, could become subject to these requirements. Although Section 1502 of the Act may not be directly applicable to non-public companies, such companies may need to provide the necessary cooperation to their customers to enable them to comply with applicable disclosure requirements.

Conflict minerals. The term "conflict minerals" for purposes of the new rules includes columbite-tantalite (coltan), cassiterite, gold, wolframite or their derivatives, or any other mineral or its derivative determined by the U.S. Secretary of State to be financing conflict in the DRC or an adjoining country. Adjoining countries are defined as countries that share a border with the DRC, and include Angola, Burundi, the Central African Republic, the Republic of the Congo, Rwanda, Sudan, Tanzania, Uganda and Zambia. "DRC conflict free" means

products that do not contain minerals that directly or indirectly finance or benefit armed groups in the DRC or adjoining countries.

Conflict minerals are used widely by many industries. For example, wolframite is the main source of the metal tungsten, which is used to make cutting tools for various industries. Tungsten is also used to make filaments in light bulbs, turbine engines for aircraft and energy generation and in various electronic components. Cassiterite is used in the production of tin, which, in turn, is used in the solder that joins electronic components together and as an alloy for other metals to prevent corrosion. Columbite-tantalite becomes tantalite when refined. Tantalite is used mainly in the manufacture of condensers and micro-electronic technology (chips and processors), cell phones and nuclear reactors. It is also used in the production of certain varieties of steel.

Disclosure requirements. Companies subject to the new requirements must disclose annually whether conflict minerals that are necessary to the functionality or production of a product manufactured by them originated in the DRC or an adjoining country. This requirement will apply to a covered company's first full fiscal year after promulgation of the SEC rules.

If a company determines that conflict minerals used by the company originate in the DRC or adjoining countries, the company would be required to disclose additional information in a report to the SEC. The disclosures in the report must be audited by an independent private sector audit to a standard to be established by the U.S. Comptroller General, in accordance with rules promulgated by the SEC in consultation with the U.S. Secretary of State, and the audit must be certified by the company submitting the report (which certification is to be viewed as a critical element of the diligence process relating to source and chain of custody of conflict minerals). The report will not be satisfactory if it relies on the independent private sector audit or other due diligence processes that the SEC deems unreliable.

The report must include the following disclosures:

- a description of the measures taken by the company to exercise due diligence regarding the source and chain of custody of conflict minerals;
- a description of the products manufactured or contracted to be manufactured that are not DRC conflict free;
- a description of the entity that conducted the audit; and
- a description of the facilities used to process the conflict minerals, the country of origin of the conflict minerals and the efforts to determine the mine or location of origin with greatest possible specificity.

The disclosure and report must be published on the company's website.

Compliance and penalties. There is no indication yet of what a company should do if it is unable to ascertain with certainty the origin of the relevant minerals. For example, if a conflict mineral had been used as an alloy for a steel vat used in a company's manufacturing process, it may be burdensome and costly to find it if that is, in fact, the case, and may be impossible to

trace the source of the mineral that was used to create the alloy. Likewise, the source of gold may be impossible to trace because gold mined in the DRC is chemically identical to gold mined elsewhere in the world since gold is a chemical element, and no test can identify the source of gold other than through reliable chain-of-custody records. The nature of penalties and the applicable standards for violations of these provisions is also unclear.

Next steps. Companies subject to Section 1502 of the Act may need to start preparing for both making and answering due diligence queries and evaluating their supply chains and existing equipment for the presence of the enumerated minerals, whether directly or indirectly. Non-public companies may also need to be prepared to provide the necessary cooperation to their SEC reporting customers. Companies may also enhance their record-keeping with respect to the supply chain sourcing. Companies may also periodically review the list of minerals deemed to be conflict minerals by the U.S. Secretary of State and address any new minerals on the list and in their supply chains or existing equipment promptly.

Mining Companies

Disclosure requirements. Section 1503 of the Act requires SEC reporting companies that operate mines directly or through a subsidiary to disclose specified mine safety information in their periodic filings. This Section of the Act does not require the SEC to issue new rules, although the SEC is authorized to do so.

SEC periodic reports of affected companies must include disclosure of citations or orders for health and safety violation issued by the Federal Mine Safety and Health Administration, as well as any pending legal action before the Federal Mine Safety and Health Review Commission. Such companies must also disclose the receipt of an imminent danger order or written notice highlighting a pattern of violations from the Federal Mine Safety and Health Administration by filing a current report on Form 8-K. Foreign private issuers are not required to file current reports on Form 8-K and thus the SEC will need to clarify whether and how this requirement will apply to foreign private issuers.

Next steps. Section 1503 took effect on August 20, 2010 and thus affected companies may need to evaluate their record keeping and internal control systems promptly to ensure that the required information is provided in their upcoming periodic filings.

Oil and Natural Gas and Mineral Extraction Companies

Disclosure requirements. Section 1504 of the Act requires disclosure of certain payments made by resource extraction companies to governments for the commercial development of oil, natural gas or minerals. The SEC is required by April 17, 2011 to promulgate rules to implement the new requirements. Such rules will become effective on the date affected companies are required to submit an annual report relating to the fiscal year that ends not earlier than one year after the date on which the SEC issues such rules.

SEC reporting companies that engage in the commercial development of oil, natural gas or minerals will have to include in their annual reports a description of any payment made by the company, a subsidiary of the company, or an entity under control of the company to a foreign government or the U.S. federal government for the purpose of the commercial development of

oil, natural gas or minerals. Commercial development of oil, natural gas or minerals includes exploration, extraction, processing, export and other significant actions relating to oil, natural gas or minerals, or the acquisition of a license for any such activity, as determined by the SEC. A "foreign government" includes a foreign government, a department, agency or instrumentality of a foreign government and a company owned by a foreign government, as determined by the SEC.

Payments. The information to be included in annual reports will include the type and total amount of the payments made for each project relating to the commercial development of oil, natural gas or minerals, and the type and total amount of such payments made to each government. "Payment" means a payment that is made to further the commercial development of oil, natural gas or minerals and is not de minimis. Covered payments include taxes, royalties, fees, bonuses, production entitlements and other material benefits that the SEC determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas or minerals.

Availability of Data. The disclosure will be public and must be provided in interactive data format.

Next steps. Companies subject to Section 1504 of the Act may need to review their existing compliance, internal controls and record-keeping systems to ensure that they would be able to extract and produce the required information for the inclusion in their reports.

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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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