Milbank

Global Securities Group

Client Alert

New York Los Angeles Washington, DC London Frankfurt Munich Beijing Hong Kong Singapore Tokyo São Paulo

CONFLICT MINERALS DISCLOSURE: A GUIDE TO COMPLYING WITH SECTION 1502 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT – ADOPTION OF NEW RULES EXPECTED FIRST HALF OF 2012

January 27, 2012

For further information about this Client Alert, please contact:

Robert W. Mullen, Jr.
Partner
212-530-5150
rmullen@milbank.com

Douglas Tanner
Partner
212-530-5505
dtanner@milbank.com

James H. Ball, Jr.
Partner
212-530-5515
jball@milbank.com

Paul Denaro
Partner
212-530-5431
pdenaro@milbank.com

Rod Miller
Partner
212-530-5022
rdmiller@milbank.com

Marcelo A. Mottesi
Partner
212-530-5602
mmottesi@milbank.com

Arnold B. Peinado III
Partner
212-530-5546
apeinado@milbank.com

Robert B. Williams
Partner
212-530-5516
rwilliams@milbank.com

You may also contact any member of Milbank's Global Securities group. Contact information can be found at the end of this Client Alert or in the Practice Areas section at www.milbank.com.

President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or the "Act") into law on July 21, 2010. Section 1502 of the Act requires the Securities and Exchange Commission (the "SEC") to promulgate disclosure and reporting regulations regarding the use of certain minerals originating in the Democratic Republic of the Congo (the "DRC") and adjoining countries (together, the "DRC countries"). This memorandum summarizes the proposed rules issued by the SEC with respect to conflict minerals, and provides guidance as to how, even before the final rule is issued and becomes applicable, issuers may begin to perform due diligence in order to satisfy the new disclosure requirements. This memorandum also provides guidance to issuers as to how they can restructure their operations and conduct "best practices" in the conflict minerals area to avoid unwanted disclosures to the market that may be required under the newly mandated disclosure.

Background

Many members of the U.S. Congress have long been concerned that the proceeds from the exploitation and trade of certain minerals originating in the DRC countries was helping to finance violence, particularly sexual- and gender-based violence, in the DRC. In response to this concern, Section 1502 was adopted to promote transparency to investors and consumer awareness regarding the minerals used to produce the goods they buy. Although Section 1502 does not outlaw the use of these minerals in products, Congress intended that by requiring companies that use minerals purchased from the DRC countries to prominently disclose this fact, it would subject them to public pressure to stop such practices, and that as a result less money will flow into the DRC countries, curbing the violence and exploitation.

Section 1502 of the Act amends the Securities Exchange Act of 1934 (the "Exchange Act") by adding new Section 13(p), which requires the SEC to issue disclosure and reporting regulations regarding the use of conflict minerals from the DRC countries (the "Conflict Minerals Rules"). The SEC issued proposed Conflict Minerals Rules on

December 15, 2010[1], with the deadline for comments on the proposals most recently extended until March 2, 2011. The SEC's most recent Dodd-Frank implementation timeline indicates that final Conflict Minerals Rules should be published not later than June 2012.[2]

Minerals covered by the rules include columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives or any other minerals or its derivatives determined by the U.S. Secretary of State to be financing the conflict in the DRC countries, regardless of their origin ("Conflict Minerals")[3]. These minerals are used to manufacture a wide range of products including laptops, mobile phones, jewelry, medical devices, airplanes and cars. As a result, this requirement will likely cause increased reporting requirements for a number of industries from electronics manufacturers to large retailers. The SEC estimated the requirement would result in over 6,000 U.S. and foreign companies filing Conflict Minerals reports.[4] It is therefore important that issuers begin to perform meaningful due diligence with respect to their suppliers in an effort to determine whether Conflict Minerals are being used, and if so, the ultimate source of such Conflict Minerals. The U.S. Department of State (the "State Department") cautions issuers that implementation of any guidelines in preparation for disclosure pursuant to the Conflict Minerals Rules will take time and will present many challenges.[5]

The Conflict Minerals Rules

Application

In crafting its due diligence procedures, an issuer must first determine whether the Conflict Minerals Rules apply to it. An issuer is only subject to the Conflict Minerals Rules if it:

- Files Form 10-K, Form 20-F or Form 40-F with the SEC under Exchange Act Sections 13(a) or 15(d); and
- The minerals described above as Conflict Minerals are "necessary to the functionality or production" of a product manufactured by the issuer or a product "contracted to be manufactured by the issuer".[6]

If an issuer does not meet one or both of the prongs of this test, it would not be required to take any action, make any disclosures, or submit any reports and its diligence inquiry would be at an end. Issuers who meet both prongs of this test ("Described Issuers") are required to determine, after what the SEC terms a "reasonable country of origin inquiry" (described below), whether the Conflict Minerals they use had in fact originated in the DRC countries.

Issuers should note that the Conflict Minerals Rules should be assumed to apply to an issuer and its subsidiaries. So, for example, if a subsidiary uses Conflict Minerals in its product, then disclosure by the parent company would also be warranted.

---

[1] Conflict Minerals, Exchange Act Release No. 34-63547, 2010 WL 5121983 (Dec. 15, 2010).

[2] SEC's Dodd-Frank Upcoming Activity timeline available at http://sec.gov/spotlight/dodd-frank.shtml (last visited Jan. 24, 2012).

[3] See Note 1.

[4] *Dodd-Frank Act: One-year Anniversary*, Score No. FV0012 (Ernst & Young LLP), July 2011, *available at* http://www.ey.com/global/assets.nsf/United%20Accounting/DoddFrank_FV0012_July2011/$file/DoddFrank_FV0012_July2011.pdf.

[5] U.S. Dep't of State, Bureau of Economic, Energy, and Business Affairs, Statement Concerning Implementation of Section 1502 of the Dodd-Frank Legislation Concerning Conflict Minerals Due Diligence (July 15, 2011) (statement of Robert D. Hormats and Maria Otero), http://www.state.gov/e/eeb/diamonds/docs/168632.htm.

[6] Securities Exchange Act, 15 U.S.C.A. 78m(p)(1)(A)(ii), Securities Exchange Act, 15 U.S.C.A. 78m(p)(2)(B).

"Necessary to the functionality or production"

The SEC has not provided a definition or any tests for when Conflict Minerals are "necessary to the functionality or production" of a product. The absence of a definition of the phrase or a test leaves the scope of the Conflict Minerals Rules unclear. The SEC does note, however, that if a Conflict Mineral is necessary to the functionality or production of a product, then such product is covered without regard to (1) the amount of the mineral involved or (2) whether the Conflict Mineral is ultimately included anywhere in the final product, so long as it was crucial to the production process.[7] In other words, there is no *de minimis* exemption for use of Conflict Minerals.

"Contracted to be manufactured by the issuer"

The SEC has indicated by the inclusion of the phrase "contracted to be manufactured" that its rules would apply to issuers that contract for the manufacturing of products with companies over which they have any influence. The rules would also apply to issuers selling generic products under their own brand name or a separate brand name that they have established, regardless of whether they have any influence over the manufacturing specifications of those products, provided that the issuer has contracted with another party to have the products manufactured specifically for it and no other issuer. The rules would not, however, apply to retail issuers that sell only the products of third parties if those retailers 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.

Reasonable Country of Origin Inquiry

Once an issuer has determined that the Conflict Minerals Rules apply to it, and it is therefore a Described Issuer, it must perform a "reasonable country of origin inquiry" to determine whether the minerals it uses did in fact originate in DRC countries. The inquiry must cover all of the minerals then contemplated as Conflict Minerals that are necessary to the functionality or production of its products that it manufactures or contracts to be manufactured. The SEC has not set forth what constitutes a "reasonable country of origin inquiry", and stated that such would depend on the issuer's particular facts and circumstances. An issuer can satisfy this requirement by obtaining reasonably reliable representations from the facility at which its minerals were processed that those minerals did or did not originate in the DRC countries. The issuer would have to reasonably believe that these representations were true based upon the facts and circumstances surrounding the representations when made. For example, one way an issuer could reasonably rely on a facility's representations is if such facility is identified as one that processes only "DRC conflict free" minerals (discussed below) under recognized standards and after receiving an independent third party audit of the source and chain of custody of the minerals it processes.

If an issuer concludes that none of its Conflict Minerals originate in the DRC countries, it would be required to:

- Disclose this fact in the body of its annual report and on its Internet website (it must retain the information on the website at least until the issuer's subsequent annual report is filed with the SEC);
- Disclose in the body of its annual report details of the reasonable country of origin inquiry it undertook to determine that the Conflict Minerals it uses did not originate in the DRC countries; and
- Maintain reviewable business records to support its determination.

[7] However, it should be noted that Conflict Minerals necessary to the functionality or production of a physical tool or machine necessary or used to produce a product would not be considered necessary to the "production" of a product.

Such an issuer would not be required to make any other disclosure with respect to the Conflict Minerals it uses. The SEC would be able to discuss with the issuer the issuer's use of Conflict Minerals and assess the reliability of the inquiry that the issuer undertook to determine that the Conflict Minerals it uses did not originate in the DRC countries. The SEC's assessment would be whether the information used provided a reasonable basis for an issuer to trace the origin of its Conflict Minerals.

If an issuer determines through its reasonable country of origin inquiry that any of the Conflict Minerals it uses did in fact originate in the DRC countries, or if the issuer is unable to determine after a reasonable country of origin inquiry if any of the Conflict Minerals it uses originated in the DRC Countries, it would be required to:

- Disclose this determination in the body of the annual report;
- Prepare a Conflict Minerals Report (discussed below) and furnish it as an exhibit to the annual report;
- Disclose that the Conflict Minerals Report is furnished as an exhibit to the annual report; and
- Make available its Conflict Minerals Report on its Internet website, disclose in the body of its annual report that the Conflict Minerals Report is posted online, and disclose in the body of its annual report the Internet address on which the Conflict Minerals Report is located.

The SEC notes that it would not be satisfactory for an issuer to conclude that it is unreasonable for it to attempt to determine the origin of the Conflict Minerals it uses solely because of the large amount of Conflict Minerals it uses in its manufacturing process or the large number of products that include such minerals. It would also not be satisfactory for an issuer to conclude that there is "no evidence" that their Conflict Minerals originated in DRC Countries, as this might incentivize issuers to conduct poorly planned or executed inquiries.

Conflict Minerals Report

The Conflict Minerals Rules require issuers who are using Conflict Minerals or who can not reliably attest to the origin of the Conflict Minerals they use to exercise due diligence on the source and chain of custody of the Conflict Minerals they use and to describe those due diligence measures in the Conflict Minerals Reports. The SEC has not provided guidance on the appropriate due diligence standard for the Conflict Minerals Report, but it is likely the diligence undertaken by a reasonably prudent person, as such may vary and evolve over time.

The principal contents of the Conflict Minerals Report are as follows:

- A description of the measures taken to exercise due diligence on the source and chain of custody of the company's Conflict Minerals, including a certified independent private sector audit of the Conflict Minerals Report;
- A certification by the issuer that it obtained such an independent private sector audit;
- A description of any of the issuer's products manufactured or contracted to be manufactured containing Conflict Minerals that are not "DRC conflict free," the facilities used to process those Conflict Minerals, the country of origin of those Conflict Minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity; and
- The audit report prepared by the independent private sector auditor, which identifies the entity that conducted the audit.

A product is "DRC conflict free" if it does not contain Conflict Minerals that directly or indirectly financed or benefited armed groups in the DRC countries. A product is not "DRC conflict free" if it does contain such Conflict Minerals. An issuer may explain in the Conflict Minerals Report that although its products may be labeled as not "DRC Conflict free," the issuer has been unable to determine the source of the Conflict Minerals.

Preparing for the Conflict Minerals Rules

The Conflict Minerals Rules will not apply to an issuer until an issuer's first full fiscal year beginning after the date of enactment of the final rules relating to Conflict Minerals. Assuming the final rules are promulgated by the SEC during their proposed timeframe of the first half of the 2012 calendar year, Conflict Minerals disclosure would be required in the annual report filed in respect of the fiscal year ended December 31, 2013 for an issuer with a calendar fiscal year. Nevertheless, there are certain steps an issuer could be taking now to prepare for the Conflict Minerals Rules application.

First, the State Department encourages companies to immediately begin to structure their supply chain relationships in a responsible and productive manner to encourage legitimate, conflict-free trade, including finding and contracting with conflict-free minerals sources from the DRC countries.[8]

Second, the SEC notes that a company whose conduct conformed to a nationally or internationally recognized set of standards of, or guidance for, due diligence regarding conflict minerals supply chains would provide evidence that the company used reasonable due diligence in making its supply chain determinations.

The State Department specifically endorses, and the SEC cites to, the guidance issued by Organization for Economic Cooperation and Development ("OECD"), Draft Due Diligence Guidelines for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (the "OECD Guidelines")[9], which included input from high-level governmental and industry stakeholders, including the United Nations Security Council DRC Sanctions Committee's Group of Experts ("UNGOE") which was instrumental in conceiving the guidelines. In September 2011, an OECD pilot study was announced with the goal of evaluating the practicability of applying the OECD Guidelines. While it is unclear whether the OECD intends to revise the language of the OECD Guidelines itself, the prevailing view is that the OECD may amend the substance of the OECD Guidelines through less informal clarifications. This pilot study is currently ongoing with preliminary high-level updates having been made public. The pilot study is anticipated to be completed by August 2012.[10]

While specific due diligence requirements and processes will differ depending on the mineral and the position of the issuer in the supply chain, the State Department encourages companies to draw upon this guidance as they establish their due diligence practices. The five-step framework is summarized below:

1. Establish strong company management systems. Issuers should:

    a. Adopt a policy for the supply chain of minerals originating from high risk areas and clearly communicate such policy to the issuer's suppliers;

---

[8] U.S. Dep't of State, Bureau of Economic, Energy, and Business Affairs, Statement Concerning Implementation of Section 1502 of the Dodd-Frank Legislation Concerning Conflict Minerals Due Diligence (July 15, 2011) (statement of Robert D. Hormats and Maria Otero), http://www.state.gov/e/eeb/diamonds/docs/168632.htm.

[9] *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas*, OECD Publishing (2011), http://www.oecd.org/dataoecd/62/30/46740847.pdf.

[10] OECD high-level findings and other related materials are available at http://www.oecd.org/document/38/0,3746,en_2649_34529562_49079014_1_1_1_34529562,00.html.

b. Structure internal management to support supply chain due diligence. This includes assigning authority and responsibility to staff with necessary competence and putting in place an organizational structure and communication processes that will ensure critical information reaches relevant employees and suppliers;

c. Establish a system of controls and transparency over the mineral supply chain;

d. Strengthen company engagement with suppliers. This could be done by incorporating an issuer's supply chain policy into contracts with suppliers; and

e. Establish a company-level, or industry-wide, grievance mechanism that would allow any interested party to raise concerns regarding the circumstances of mineral extraction, trade, handling and export in conflict-affected and high-risk areas.

2. Identify and assess risk in the supply chain. Issuers should:

a. Identify and assess risks on the circumstances of extraction, trading, handling and export of minerals from conflict-affected and high-risk areas; and

b. Among other things, identify the smelters in their supply chain and obtain information from them regarding the country of mineral origin, transit and transportation routes used between mines and smelters.

3. Design and implement a strategy to respond to identified risks. Issuers should:

a. Report findings to senior management of the company;

b. Devise a strategy for risk management by either (i) continuing trade throughout the course of risk mitigation efforts; (ii) temporarily suspending trade while pursuing ongoing risk mitigation; or (iii) disengaging with a supplier after failed attempts at mitigation or where a company deems risk mitigation not feasible or unacceptable.

c. Implement the risk management plan, monitor and track performance of risk mitigation, report back to designated senior management and consider suspending or discontinuing engagement with a supplier after failed attempts at mitigation; and

d. Undertake additional fact and risk assessments for risks requiring mitigation.

4. Plan and carry out an independent third-party audit of supply chain due diligence at identified points in the supply chain.

5. Report on supply chain due diligence by publicly reporting on their supply chain due diligence policies and practices.

Finally, issuers may take advantage of new certification criteria being developed by a number of third-party organizations to assure themselves that materials used are conflict mineral-free. Such organizations include the Electronic Industry Citizenship Coalition ("EICC") and the Global e-Sustainability Initiative ("GeSi"), whose membership includes numerous companies such as Apple, Sony, Nokia, Ericsson, AT&T, Deutsche Telecom, Verizon, RIM and others. Other industry associations have also commenced initiatives to develop compliance standards, such as the International Tin Research Institute ("ITRI") and the International Conference on the Great Lakes Region ("ICGLR"), an inter-governmental organization of countries in the African great lakes region.

EICC and GeSi established the Conflict-Free Smelter ("CFS") assessment program, in which an independent third party evaluates a smelter's procurement activities and determines if the smelter demonstrated that all the materials it processed originated from conflict-free sources.[11] Under this program, smelters can voluntarily apply to be certified as conflict-free, enabling issuers who obtain metals from these smelters to certify that they are DRC conflict-free. The ITRI also initiated the ITRI Tin Supply Chain Initiative ("iTSCi") to establish a traceability system for cassiterite, track tin and tantalum ore in Rwanda and Congo from mine to exporter, and to establish tracing and documentation standards, with the goal of assisting companies in meeting the due diligence expectations of the international community including the United Nations, the OECD, and Dodd-Frank.[12] The ICGLR has adopted a set of key principles for a regional minerals certification process and is working to further develop that process with the goal of establishing chain of custody tracking from mine site to export and regional tracking of mineral flows via a publically-accessible database.

Issuers Publicly Addressing the Conflict Minerals Rules

In response to the Act and in anticipation of the conflict mineral disclosure requirement applying to their businesses, many issuers around the world have taken steps toward tracing the source of their product materials and avoiding the use of Conflict Minerals from the DRC Countries in their products going forward. For example, several companies, including Motorola and Intel, have added requirements to their supplier contracts to trace and certify the origin of Conflict Minerals used in their products.[13] HP requires its suppliers to only procure minerals in a way that ensures that they are not financing armed groups.[14] Industry giants Apple and Intel, and other companies involved in the Conflict-Free Smelter program, have announced the termination of sales of products using Conflict Minerals which contribute to the conflict in eastern Congo effective April 2011.[15]

In addition, foreign private issuers have also started taking steps to commence compliance with the anticipated Conflict Mineral Rules. Sony supports the initiatives of the EICC and GeSi, and asks suppliers to verify whether violations of basic human rights took place at any step in the supply chain.[16] Panasonic Corp. and Kyocera Corp. vowed in July 2011 to eschew all use of Conflict Minerals in light of the Conflict Minerals Rules.[17] Both Panasonic and Kyocera have instructed their subsidiary businesses to refrain from using Conflict Minerals and are working with parts suppliers to trace the sources of product materials. Further, automakers, which use a large number of electronic control parts, are also gearing up for the implementation of the final conflict mineral regulations by educating their boards about the law and exploring ways to cooperate with parts suppliers.[18]

---

[11] *EICC®-GeSI Conflict-Free Smelter (CFS) Assessment Program, FAQ*, Electronic Industry Citizenship Coalition (Rev. May 25, 2011), http://www.eicc.info/documents/Conflict-FreeSmelterFAQ.pdf.

[12] Information about the itsci can be found on http://www.itri.co.uk/index.php?option=com_zoo&view=frontpage&Itemid=60.

[13] *Dodd-Frank Act Conflict Minerals (Section 1502)* (KPMG), June 2, 2011, *available at* http://www.fjata.org/wp-content/uploads/Dodd-Frank-2.pdf.

[14] http://www.hp.com/hpinfo/globalcitizenship/society/conflict_minerals.html.

[15] Michael J. Kavanagh, *Apple, Intel-Backed Rules on Conflict Minerals Stall Exports*, Bloomberg.com (Apr. 1, 2011), http://www.bloomberg.com/news/2011-04-01/apple-intel-backed-ban-on-conflict-minerals-may-help-spur-exports-to-asia.html.

[16] Sony Ericsson *Statement on Conflict Minerals* (August 2011) available at http://dl-www.sonyericsson.com/cws/download/1/102/468/2/1314341444/Statement_on_Coflict_Minerals_Aug2011.pdf.

[17] *Panasonic Kyocera to Shun African Conflict Minerals*, Nikkei.com (July 12, 2011).

[18] Id.

Several industry giants, including AMD, HP, Intel, Motorola, Nokia, Sprint and Sony, as well as various industry groups and NGOs have also recently joined a U.S. government-led effort to create a reputable supply chain for Conflict Minerals. The Public-Private Alliance for Responsible Minerals Trade launched at the end of 2011 intends to develop a pilot network of supply chain systems based on mines that have been audited and certified as conflict-free, and plans to set up an online resource for companies that want information about responsible sourcing of minerals.[19]

Conclusion

Given the significant burdens that the Conflict Minerals Rules might impose on issuers, it is critical that companies begin to perform meaningful due diligence with respect to Conflict Minerals in preparation for any required disclosure they might need to provide. Issuers in the electronics and communications, aerospace, automotive, jewelry and industrial manufacturing industries, in particular, are at risk of using Conflict Minerals in their products and should begin to take the steps outlined in this memorandum.

[19] http://www.resolv.org/site-ppa/.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any member of our Global Securities group listed below.

Beijing

Anthony Root	+86-10-5969-2777	aroot@milbank.com
Edward T. Sun	+86-10-5969-2772	esun@milbank.com

Frankfurt

Thomas Ingenhoven	+49-69-71914-3436	tingenhoven@milbank.com

Hong Kong

Anthony Root	+852-2971-4842	aroot@milbank.com
Gary S. Wigmore	+852-2971-4815	gwigmore@milbank.com
Dieter Yih	+852-2971-4888	dyih@milbank.com
Joshua M. Zimmerman	+852-2971-4811	jzimmerman@milbank.com

London

Peter Schwartz	+44-20-7615-3045	pschwartz@milbank.com
Tim Peterson	+44-20-7615-3106	tpeterson@milbank.com

Los Angeles

Kenneth J. Baronsky	+1-213-892-4333	kbaronsky@milbank.com
Deborah J. Ruosch	+1-213-892-4671	druosch@milbank.com
Neil J. Wertlieb	+1-213-892-4410	nwertlieb@milbank.com

Munich

Peter Nussbaum	+49-89-25559-3630	pnussbaum@milbank.com

New York

James H. Ball, Jr.	+1-212-530-5515	jball@milbank.com
Paul Denaro	+1-212-530-5431	pdenaro@milbank.com
Andrew Janszky	+1-212-530-5317	ajanszky@milbank.com
Rod Miller	+1-212-530-5022	rdmiller@milbank.com
Marcelo A. Mottesi	+1-212-530-5602	mmottesi@milbank.com
Robert W. Mullen, Jr.	+1-212-530-5150	rmullen@milbank.com
Arnold B. Peinado, III	+1-212-530-5546	apeinado@milbank.com
Douglas A. Tanner	+1-212-530-5505	dtanner@milbank.com
Robert B. Williams	+1-212-530-5516	rwilliams@milbank.com

São Paulo

Andrew Janszky	+55-11-3927-7701	ajanszky@milbank.com
Tobias Stirnberg	+55-11-3927-7702	tstirnberg@milbank.com

Singapore

Naomi J. Ishikawa	+65-6428-2525	nishikawa@milbank.com
Giles Kennedy	+65-6428-2425	gkennedy@milbank.com

Tokyo

Mark Plenderleith	+813-5410-2842	mplenderleith@milbank.com
Yoku Kiuchi	+813-5410-2801	ykiuchi@milbank.com

Washington, DC

Winthrop N. Brown	+1-202-835-7514	wbrown@milbank.com