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SEC ADOPTS FINAL CONFLICT MINERALS DISCLOSURE RULES

On August 22, 2012, the Securities and Exchange Commission (the "SEC") adopted final rules to implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Section 1502 was adopted as a result of concerns of members of Congress that the proceeds from the exploitation and trade of certain minerals originating in the Democratic Republic of the Congo (the "DRC") and adjoining countries (together, the "Covered Countries") are helping to finance violence, particularly sexual- and gender-based violence, in the Covered Countries giving rise to a humanitarian crisis. Section 1502 of the Act amended the Securities Exchange Act of 1934 (the "Exchange Act") to add new Section 13(p) which requires the SEC to promulgate new disclosure standards for issuers concerning their use of these minerals (the "Conflict Minerals Rules"). As promulgated, the minerals covered by the rules include columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives (currently limited to tantalum, tin and tungsten), or any other minerals or derivatives thereof determined by the U.S. Secretary of State to be financing conflict in the Covered Countries regardless of their origin ("Conflict Minerals"). This memorandum summarizes the final Conflict Minerals Rules and suggests compliance steps which SEC-reporting companies should take to comply with these rules.

The Conflict Minerals Rules

The Conflict Minerals Rules were promulgated as new Rule 13p-1 under the Exchange Act and the items of Form SD. The Conflict Minerals Rules in pertinent part require an SEC-reporting issuer "having conflict minerals that are necessary to the functionality or production of a product manufactured or contracted by that registrant to be manufactured" to make a report on Form SD setting forth its determination of whether such Conflict Minerals originated in the Covered Countries or were derived from scrap or recycled materials[1]. Depending on this determination, additional disclosure may be required on Form SD ranging from a brief description of the inquiry

1 Defined in conformity to the definition used by the Organisation for Economic Co-operation and Development as being from recycled metals, which are reclaimed end-user or post-consumer products, or scrap processed metals created during product manufacturing, with "recycled metal" including excess, obsolete, defective, and scrap metal materials that contain refined or processed metals that are appropriate to recycle in the production of tin, tantalum, tungsten and/or gold. However, the SEC stated in the adopting release that minerals partially processed, unprocessed, or a byproduct from another ore will not be included in the definition of recycled metal.

the issuer conducted to a description of the measures taken to exercise due diligence on the source and chain of custody of the issuer's Conflict Minerals with an accompanying auditor report.

The Three Step Test

To determine what, if any, disclosure is required by the Conflict Mineral Rules, issuers should apply the following three step test.

Step One: Applicability

The final rules are applicable only to an issuer which (1) files reports with the SEC under Sections 13(a) or 15(d) of the Exchange Act and (2) determines that Conflict Minerals actually contained in its products are "necessary to the functionality or production" of a product "manufactured or contracted to be manufactured" by it.

An issuer must make a good faith determination whether the Conflict Minerals Rules apply to it. If the issuer does not meet both prongs of this test, it is not required to take any action, make any disclosures or submit any reports and its diligence inquiry would be at an end.

The final rules require an issuer which meets both prongs of this test to determine, after a "reasonable country of origin inquiry" (described below), whether the Conflict Minerals contained in its products in fact originated in any of the Covered Countries or were derived from scrap or recycled materials.

"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. However, the adopting release provides some guidance to issuers in determining whether a Conflict Mineral is "necessary to the functionality" of a product, advising issuers to consider: (1) whether the Conflict Mineral is intentionally added to the product or any component of the product and is not a naturally-occurring by-product; (2) whether the Conflict Mineral is necessary to the product's generally expected function, use or purpose (including for the purpose of serving only one out of many functions); and (3) if the Conflict Mineral is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration. Based on the applicable facts and circumstances, any of the above factors, either individually or in the aggregate, may be determinative as to whether Conflict Minerals are "necessary to the functionality" of a given product.

The adopting release also provides guidance relating to the criteria to consider when assessing whether a Conflict Mineral is "necessary to the production" of a product, advising issuers to consider (1) whether the Conflict Mineral is intentionally included in the product's production process, other than if it is included in a tool, machine, or equipment used to produce the product (such as computers or power lines); (2) whether the Conflict Mineral is included in the product; and (3) whether the Conflict Mineral is necessary to produce the product. Effectively, the SEC states that the Conflict Mineral must be both contained in the product and necessary to the product's production. Accordingly, a Conflict Mineral is not "necessary to the production" of a product if the Conflict Mineral is used as a catalyst, or in a similar manner in another process, that is necessary to produce the product but is not contained in that product even in trace amounts.

The SEC further noted that if a Conflict Mineral is necessary to the functionality or production of a product, then the product is covered without regard to the amount of the mineral involved if the final product contains any Conflict Minerals. In other words, there is no *de minimis* exemption for use of Conflict Minerals. However, as mentioned above, where Conflict Minerals are solely used in the production process but the final product does not contain any Conflict Minerals, the Conflict Minerals Rules would not apply.

"Manufactured or contracted to be manufactured by the issuer"

The SEC has not defined "manufactured" or "contracted to be manufactured" in the Conflict Minerals Rules, but the SEC has expressed the view that the Conflict Minerals Rules apply to issuers that manufacture (as such term is commonly understood) their own products or that contract for the manufacturing of products with companies over which they have actual influence. Servicing, maintaining, or repairing a product manufactured by a third party does not cause a product to be deemed to be "manufactured" by an issuer.

Furthermore, the SEC adopting release clarifies that with respect to assessing the degree of influence exercised with respect to a product "contracted to be manufactured" by a third party, the issuer should make the determination based on a facts and circumstances analysis that takes into account the influence exercised by the issuer over the materials, parts, ingredients or components to be included in the product. Accordingly, an issuer would not meet this prong of the test if it merely: (1) affixes its brand, marks, logo, or label to a generic product manufactured by a third party; (2) services, maintains or repairs a product manufactured by a third party; or (3) specifies or negotiates contractual terms with a manufacturer that do not directly relate to the manufacturing of the product, unless such contractual terms are negotiated to such a degree so as to render the issuer as having practically exercised influence directly relating to the manufacturing of a product.

Step Two: Reasonable Country of Origin Inquiry

The final rules require that any issuer subject to the Conflict Minerals Rules perform a "reasonable country of origin inquiry" to determine whether the minerals it uses did in fact originate in the Covered Countries or come from recycled or scrap sources. The inquiry must cover all of the Conflict Minerals that are necessary to the functionality or production of the products which it manufactures or contracts to be manufactured. The SEC adopting release does not set forth the nature and extent of what constitutes a "reasonable country of origin inquiry", providing that it depends on the issuer's particular facts and circumstances, including factors such as the issuer's size, products, relationship with suppliers, as well as other factors. The adopting release further suggests that the inquiry must be reasonably designed to determine whether the Conflict Minerals originated in the Covered Countries or are from recycled or scrap sources and must be performed in good faith. The issuer must exercise due diligence on the source and chain of custody of its Conflict Minerals and provide a Conflict Minerals Report (described below) if, based on its reasonable country of origin inquiry, the issuer knows that it has necessary Conflict Minerals that originated in the Covered Countries and did not come from recycled or scrap sources, or if the issuer has reason to believe that its necessary Conflict Minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources.

One way an issuer can satisfy this requirement is by obtaining reasonably reliable representations from the facility at which the Conflict Minerals used in its products were processed regarding the origin and recycled/scrap nature of its Conflict Minerals. 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,

the SEC adopting release states that one way an issuer could reasonably rely on a facility's representations is if such facility is identified as one that processes only "conflict free" minerals by a recognized industry group that requires an independent private sector audit. The issuer would not then be required to receive representations from its entire supply chain (a level of diligence contemplated by the Conflict Minerals Report) provided it does not ignore warning signs or other circumstances indicating that its remaining Conflict Minerals originated or may have originated in the Covered Countries or did not or may not have come from recycled or scrap sources.

If as a result of its reasonable country of origin inquiry the issuer (1) knows that the Conflict Minerals did not originate in the Covered Countries or are from recycled or scrap sources[2] or (2) has no reason to believe that the Conflict Minerals may have originated in the Covered Countries or reasonably believes that they may be from recycled or scrap sources, it must:

- Disclose its determination regarding the Conflict Minerals it uses and provide a brief description of the inquiry it conducted and the results of that inquiry on new Form SD;
- Publicly disclose the description of its inquiry on its Internet website (and it must retain the information on the website for one year); and
- Provide its Internet address in the Form SD.

If an issuer determines through its reasonable country of origin inquiry that any of the Conflict Minerals it uses (1) did in fact originate in the Covered Countries or did not come from recycled or scrap sources, (2) has reason to believe that the Conflict Minerals may have originated in the Covered Countries or may not be from recycled or scrap sources, or (3) is unable to determine if any of the Conflict Minerals it uses originated in the Covered Countries, it would be required to conduct further due diligence on the source and chain of custody of its Conflict Minerals and file a Conflict Minerals Report as an exhibit to its Form SD. Due Diligence must conform to a nationally or internationally recognized due diligence framework, such as the guidance approved by the Organisation for Economic Co-operation and Development.[3] If as a result of such due diligence an issuer is able to conclude the Conflict Minerals did not originate in the Covered Countries or are from recycled or scrap sources[4], then it only need take the steps outlined above. Otherwise, the issuer must, in addition to the above requirements, make publicly available a Conflict Minerals Report (as described below) on its Internet website (and it must retain the report on the website for one year).

2 It should be noted that for this purpose, the Conflict Minerals Rules exclude any Conflict Minerals that are "outside the supply chain" prior to January 31, 2013. Conflict Minerals are considered to be "outside the supply chain" if such Conflict Minerals have been smelted (in the case of tantalum, tin, or tungsten) or refined (in the case of gold), or, if not smelted or refined, are physically located outside of the Covered Countries.

3 Available at http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/46740847.pdf.

4 Products with conflict minerals from recycled or scrap sources are deemed to be "DRC conflict free" and therefore an issuer with conflict minerals from recycled or scrap sources does not need to provide a Conflict Minerals Report, but must disclose how they have determined that Conflict Minerals are genuine scrap or recycled. Due diligence procedures for determining whether gold, the only Conflict Mineral for which a due diligence framework exists, is scrap or recycled will necessitate an audit if a Conflict Minerals Report is required. An audit of the due diligence procedures is not required for the other Conflict Minerals where such materials are scrap or recycled, though the Conflict Minerals Report must include a description of the due diligence measures taken to make the determination that such minerals are scrap or recycled.

Step Three: Conflict Minerals Report

The final Conflict Minerals Rules require issuers who are using Conflict Minerals or who can not reliably attest to the origin of the Conflict Minerals to prepare a Conflict Minerals Report, which in turn must be audited by an independent private sector auditor according to the Yellow Book[5], with the issuer certifying the audit. 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 issuer's Conflict Minerals;
- A description of any of the issuer's products manufactured or contracted to be manufactured containing Conflict Minerals that "have not been found to be '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;
- If an audit is required, a certification by the issuer that it obtained such an independent private sector audit; and
- If required, an 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 Covered Countries. A product is not "DRC conflict free" if it does contain such Conflict Minerals. In making these determinations, issuers may look to the State Department's conflict minerals map[6] or its promulgated guidance[7], although they may also look to other internationally recognized systems of due diligence as guides.

An issuer which has performed its due diligence duties but is unable to procure the required information as to the source of its Conflict Minerals and whether its products are "DRC conflict free" is permitted, during a limited transition period[8], to determine that its products are "DRC conflict undeterminable" and must set out in its Conflict Minerals Report the following:

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5 U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-331G, GOVERNMENT AUDITING STANDARDS 2011 REVISION (Dec. 2011), available at http://www.gao.gov/assets/590/587281.pdf. According to the adopting release, the objective of the audit is to express an opinion or conclusion as to whether the design of the issuer's due diligence measures as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is in conformity with, in all material respects, the criteria set forth in the nationally or internationally recognized due diligence framework used by the issuer, and whether the issuer's description of the due diligence measures it performed as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is consistent with the due diligence process that the issuer undertook.

6 See STATE DEPARTMENT, HUMANITARIAN INFORMATION UNIT, DEMOCRATIC REPUBLIC OF THE CONGO MINERAL EXPLOITATION BY ARMED GROUPS MAP (Jun. 14, 2011), available at https://hiu.state.gov/Products/DRC_MineralExploitation_2010Jun28_HIU_U182.pdf.

7 See STATE DEPARTMENT, 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), available at http://www.state.gov/e/eb/diamonds/docs/168632.htm.

8 It should be noted that for a temporary two year period (four year period for "smaller reporting companies", as such term is defined in Rule 12b-2 under the Exchange Act), issuers are permitted to resort to the "DRC conflict undeterminable" classification, and an independent audit of the Conflicts Minerals Report is not required, if the issuer is unable to determine, after the exercise of due diligence, (i) with respect to Conflict Minerals in its products which originated in the Covered Countries, whether they are "DRC Conflict Free," or (ii) with respect to Conflict Minerals in its products which may have originated in the Covered Countries and may not have come from recycled or scrap sources, the Conflict Minerals' country of origin, whether the Conflict Minerals financed or benefited armed groups in the Covered Countries, or whether the Conflict Minerals came from recycled or scrap sources.

- A description of the measures taken to exercise due diligence on the source and chain of custody of the issuer's Conflict Minerals;

- The steps the issuer has taken or will take, if any, since the end of the period covered in its most recent prior Conflict Minerals Report to mitigate the risk that its necessary Conflict Minerals benefit armed groups, including any steps to improve its due diligence;

- The country of origin of the Conflict Minerals, if known;

- The facilities used to process the conflict minerals, if known; and

- The efforts the issuer has made to determine the mine or location of origin of the Conflict Minerals with the greatest possible specificity, if applicable.

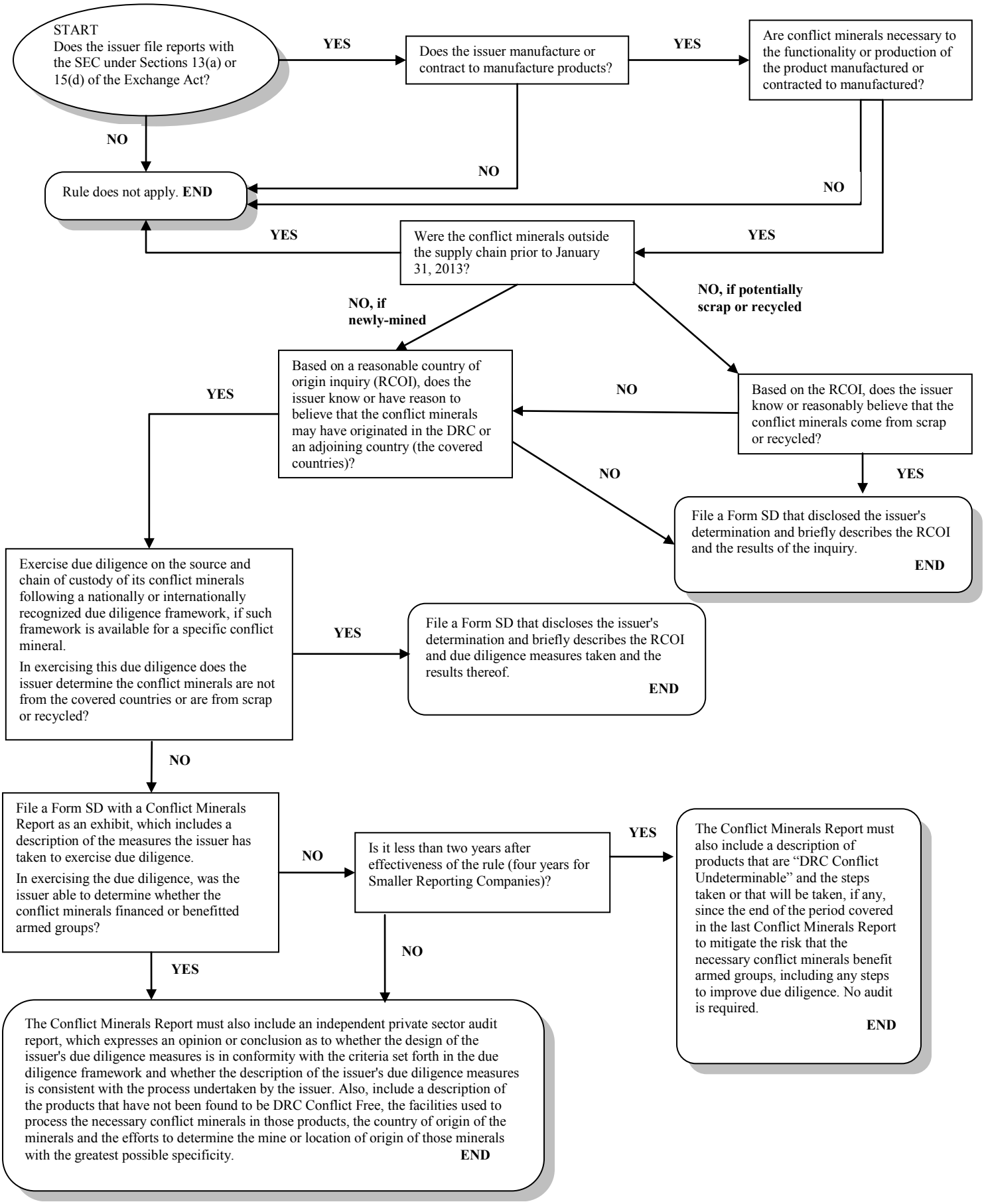
A flow chart that clarifies the inquiry process relating to the applicability of the rules and compliance therewith is attached hereto as Exhibit A.

Additional Considerations

The Conflict Minerals Rules are applicable to all issuers on a calendar year basis (irrespective of such issuer's fiscal year) starting with the calendar year commencing on January 1, 2013 (with the Form SD for each such calendar year period due on the following May 31 - i.e., the Form SD covering the 2013 calendar year would be due on May 31, 2014). The Form SD is considered to be "filed" with, not "furnished" to, the SEC and therefore is subject to the liability provisions of Section 18 of the Exchange Act.

Global Securities associates Jay Southgate and Sam Badawi assisted in the preparation of this Client Alert.

EXHIBIT A


START
Does the issuer file reports with the SEC under Sections 13(a) or 15(d) of the Exchange Act?
YES
Does the issuer manufacture or contract to manufacture products?
YES
Are conflict minerals necessary to the functionality or production of the product manufactured or contracted to manufactured?
NO
Rule does not apply. END
NO
NO
YES
Were the conflict minerals outside the supply chain prior to January 31, 2013?
YES
NO, if newly-mined
NO, if potentially scrap or recycled
YES
Based on a reasonable country of origin inquiry (RCOI), does the issuer know or have reason to believe that the conflict minerals may have originated in the DRC or an adjoining country (the covered countries)?
NO
Based on the RCOI, does the issuer know or reasonably believe that the conflict minerals come from scrap or recycled?
NO
YES
File a Form SD that disclosed the issuer's determination and briefly describes the RCOI and the results of the inquiry.
END
Exercise due diligence on the source and chain of custody of its conflict minerals following a nationally or internationally recognized due diligence framework, if such framework is available for a specific conflict mineral.
In exercising this due diligence does the issuer determine the conflict minerals are not from the covered countries or are from scrap or recycled?
YES
File a Form SD that discloses the issuer's determination and briefly describes the RCOI and due diligence measures taken and the results thereof.
END
NO
File a Form SD with a Conflict Minerals Report as an exhibit, which includes a description of the measures the issuer has taken to exercise due diligence.
In exercising the due diligence, was the issuer able to determine whether the conflict minerals financed or benefitted armed groups?
NO
Is it less than two years after effectiveness of the rule (four years for Smaller Reporting Companies)?
YES
The Conflict Minerals Report must also include a description of products that are "DRC Conflict Undeterminable" and the steps taken or that will be taken, if any, since the end of the period covered in the last Conflict Minerals Report to mitigate the risk that the necessary conflict minerals benefit armed groups, including any steps to improve due diligence. No audit is required.
END
YES
NO
The Conflict Minerals Report must also include an independent private sector audit report, which expresses an opinion or conclusion as to whether the design of the issuer's due diligence measures is in conformity with the criteria set forth in the due diligence framework and whether the description of the issuer's due diligence measures is consistent with the process undertaken by the issuer. Also, include a description of the products that have not been found to be DRC Conflict Free, the facilities used to process the necessary conflict minerals in those products, the country of origin of the minerals and the efforts to determine the mine or location of origin of those minerals with the greatest possible specificity.
END

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