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CONFLICT MINERALS: UNDERSTANDING THE SEC'S FINAL RULES

To Our Clients and Friends:

At an open meeting held on August 22, 2012, the Securities and Exchange Commission ("SEC") voted to approve final rules regarding disclosure and reporting requirements with respect to the use of "conflict minerals" to implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The final rules were adopted by a vote of 3 to 2, with Commissioners Paredes and Gallagher dissenting. The adopting release containing the final rules is available here.

The SEC issued proposed conflict minerals rules on December 15, 2010, which we described in our December 15, 2010 client alert, available here. Adoption of the final rules was delayed as the SEC sought additional comment on the proposed rules and held a public roundtable in October 2011, detailed in our client alert, available here, to gather additional information. A summary of the final rules is set forth below, followed by a description of related guidance and ongoing developments in conflict minerals supply chain initiatives. We conclude with suggested steps that companies may take to facilitate compliance with the new rules. Appendix I to this alert contains a flow chart summary of the final rules taken from the SEC adopting release. Appendix II details the development of conflict minerals supply chain initiatives, which are intended to enable the disclosure scheme envisioned by the rules.

Please join Gibson Dunn for our complimentary webcast briefing, "Conflict Minerals: Understanding the SEC's Final Rules," on Tuesday, September 18. For more information, click here.

Timing of Implementation and Reporting Obligation

Reports pursuant to the conflict minerals rules are required on a calendar year basis, regardless of an issuer's fiscal year, and are due by May 31 for the prior calendar year. Issuers must comply with the final rules for the calendar year commencing January 1, 2013. Thus, all affected issuers will make their first conflict minerals disclosures no later than May 31, 2014 for the 2013 calendar year. As discussed in further detail below, during a transition period that spans the first two calendar years of reporting (four years for smaller reporting issuers), issuers may follow a modified reporting structure for products containing minerals that are "DRC Conflict Undeterminable."

The Conflict Minerals Rules

A. Overview

Section 1502 of the Dodd-Frank Act requires the SEC to adopt rules requiring public companies to provide certain disclosures relating to conflict minerals used in their products. The intent of the Dodd-Frank mandate is to curb violence and human rights abuses in the Democratic Republic of the Congo

(the "DRC") and its adjoining countries (collectively, the "Covered Countries") that may be fueled by proceeds from trade in these minerals through required disclosure, consumer transparency and public pressure on companies that source conflict minerals from the region.

The final rules, like the proposed rules, set forth a three-step process necessary for compliance. First, each issuer must determine whether it is subject to the conflict minerals rules. The rules impose reporting requirements when conflict minerals are "necessary to the functionality or production" of a product that an issuer manufactures or has "contracted to manufacture." If an issuer does not meet this test, it is not subject to the conflict minerals rules.

Second, issuers who determine that they are subject to the conflict minerals rules must conduct, in good faith, a reasonable country of origin inquiry that is reasonably designed to determine whether their conflict minerals originated in the Covered Countries or are from recycled or scrap sources. Issuers must disclose the nature and results of their inquiry on new Form SD that is filed with the SEC via the EDGAR filing system and on their website. If, following the reasonable country of origin inquiry, the issuer (a) knows that its conflict minerals originated in the Covered Countries and that they did not come from recycled or scrap sources or (b) has reason to believe that its conflict minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources, it must proceed to the third step.

Third, an issuer that knows or has reason to believe that its conflict minerals originated in the Covered Countries and are not from recycled or scrap sources must exercise due diligence on the source and chain of custody of its conflict minerals. Following its due diligence, unless the issuer determines that its conflict minerals did not originate in the Covered Countries or that its conflict minerals did come from recycled or scrap sources, the issuer must file a Conflict Minerals Report as an exhibit to its Form SD and publish the Conflict Minerals Report on its website. In most circumstances, the issuer must obtain an independent private sector audit of the Conflict Minerals Report.

This three-step process is illustrated in a flowchart in Appendix I.

B. Definition of "Conflict Minerals"

Under Section 1502, conflict minerals include cassiterite, columbite-tantalite, gold, and wolframite, or their derivatives, as well as any other minerals or their derivatives determined by the U.S. Secretary of State to be financing conflict in the Covered Countries. The final rules track the statutory language in defining conflict minerals, except that they specifically limit the derivatives of cassiterite, columbite-tantalite, gold, and wolframite to tantalum, tin, and tungsten (known as the "3Ts"), unless the Secretary of State determines that additional derivatives are financing conflict in the Covered Countries.

The 3Ts and gold are used to manufacture a wide variety of products, including consumer electronics such as cellular phones, computers, digital cameras, MP3 players, and video game consoles, as well as aerospace, automobile, communications, and electronic equipment, and jewelry.

C. Step One: Applicability of the Conflict Minerals Rules

a) *Issuers that File Reports Under Section 13(a) or 15(d)*

The final rules apply to any issuer that files reports with the SEC under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"). There is no exception for foreign private issuers, emerging growth issuers, or smaller reporting issuers, although smaller reporting companies may take advantage of the temporary "DRC Conflict Undeterminable" reporting category, discussed below, for four years rather than the two years available to other issuers.

b) *Necessary to Functionality or Production*

Issuers are subject to the conflict minerals rules if conflict minerals are "necessary to the functionality or production of a product" the issuer manufactures or has contracted to manufacture. The final rules, like the proposed rules, do not define the phrases "necessary to the functionality" or "necessary to the production." However, the adopting release provides interpretive guidance of these terms, discussed below.

As an initial matter, and contrary to the position set forth in the proposing release, the adopting release states that only a conflict mineral that is "contained" in a product may be necessary to the functionality or production of the product. Thus, the final rules do not apply to products for which conflict minerals operate as a catalyst in the production process, but do not appear in the final product. The adopting release also states that whether a conflict mineral is intentionally added to the product, rather than being a naturally occurring by-product, is a "significant factor" in determining if the conflict mineral is necessary to the functionality or production of a product. In this regard, however, the adopting release expressly rejects any distinction based on whether the conflict mineral is added directly to the product by the issuer or is added to a component of the product that the issuer receives from a third party; in either instance, the conflict mineral would be considered to have been intentionally added.

In determining whether conflict minerals are necessary to the *functionality* of a product, the adopting release provides the following guidance:

- if a conflict mineral is necessary to any of the product's generally expected functions, uses, or purposes, it is necessary to the functionality of the product; a conflict mineral need not be necessary to each of the product's functions, uses, or purposes;[1] and

- if a conflict mineral is incorporated for purposes of ornamentation, decoration, or embellishment and the primary purpose of the product is other than ornamentation or decoration, that conflict mineral is less likely to be necessary to the functionality of the product.

In addition, the adopting release, like the proposed rules, provides that a conflict mineral contained in a physical tool or machine used to produce a product is insufficient to trigger coverage, even if that tool or machine is necessary to producing the product. Similarly, equipment indirectly used to produce a product, such as computers and power lines, do not bring the product that is produced within the scope of the "necessary to the production" phrase.

Like the proposed rules, and in spite of a large number of commentator requests, the final rules do not include a *de minimis* exception for products containing small amounts of conflict minerals.

c) *Manufacture or Contract to Manufacture*

The final rules do not define "contract to manufacture," but the release provides guidance to issuers. An issuer's determination of whether it "contracts to manufacture" will focus on the degree of influence the issuer exercises over the product's manufacturing, including the materials, parts, ingredients, or components.

The guidance to the final rules makes a significant departure from the guidance included with the proposed rules. The guidance in the proposing release provided that the rules would cover an issuer that contracts for the manufacturing of products where it has "any influence" over the manufacturing of those products. The guidance to the final rules indicates that instead that the rules apply to issuers that have "some actual influence" over manufacturing, although it is not necessary for an issuer to have "substantial" influence or control, in order for it to be considered "contracting to manufacture."

Thus, the issuer will not be deemed to have influence over manufacturing if it merely: (1) affixes its brand, marks, logo, or label to a generic product manufactured by a third party; (2) specifies or negotiates contractual terms with a manufacturer that do not directly relate to the manufacturing of the product; or (3) services, maintains, or repairs a product manufactured by a third party. For example, the release states that when a service provider requires that a cell phone purchased from a manufacturer be able to function on a certain network, this alone is not sufficient to be deemed "contract to manufacture." On the other hand, if an issuer specifies that a particular conflict mineral be included in a product, this would be sufficient to be deemed "contract to manufacture."

d) *Mining as Manufacturing*

The final rules, unlike the proposed rules, do not apply to issuers that mine or contract to mine conflict minerals unless they also engage in manufacturing, either directly or through contract.

D. Step Two: Determining Whether Conflict Minerals Originated in the Covered Countries and the Resulting Disclosure

a) *Reasonable Country of Origin Inquiry*

Issuers subject to the conflict minerals rules must conduct a "reasonable country of origin inquiry" regarding whether their conflict minerals originated in the Covered Countries or came from recycled or scrap sources. The final rules, like the proposed rules, do not define "reasonable country of origin inquiry" or specify the steps and outcomes necessary to satisfy the requirement. They instead adopt a flexible approach that depends on the issuer's "particular facts and circumstances," including its size, products, and relationships with suppliers, as well as the "available infrastructure at a given point in time." However, the final rules include general standards governing the inquiry. First, the issuer's reasonable country of origin inquiry must be "reasonably designed to determine" whether the issuer's conflict minerals originated in the Covered Countries or came from recycled or scrap sources. Second, the inquiry must be conducted "in good faith."

The adopting release makes clear that the reasonable inquiry does not require issuers to determine "to a certainty" that all of their conflict minerals did not originate in the Covered Countries. The adopting release states that an issuer satisfies the reasonable country of origin inquiry standard if it seeks and obtains reasonable representations that indicate the facility at which its conflict minerals were processed (a refiner, in the case of gold, or a smelter, in the case of the other conflict minerals) and demonstrate that those conflict minerals did not originate in the Covered Countries or did come from recycled or scrap sources. The adopting release further states:

- In determining whether it is reasonable to rely on representations, issuers must take into account any "warning signs" or other circumstances suggesting that their conflict minerals may have originated in the Covered Countries or did not come from recycled or scrap sources. According to the adopting release, the following scenarios would constitute warning signs:
    - an issuer becoming aware that some of its conflict minerals were processed by smelters that source from many countries, including the Covered Countries, but being unable to determine whether the particular conflict minerals it received from this "mixed smelter" were from the Covered Countries; or
    - an issuer receiving representations that its conflict minerals originated in a country that has limited known reserves of the conflict mineral in question.
- On the other hand, an issuer would have reason to believe representations were true if they came from a processing facility that received a "conflict-free" designation from a recognized industry group requiring an independent private sector audit, or, if the processing facility independently obtained and made publicly available an independent private sector audit of its supply chain.
- An issuer is not required to receive representations from all of its suppliers in response to its reasonable country of origin inquiry. The adopting release states that absent warning signs relating to those conflict minerals about which it did not receive supplier responses, an issuer may conclude that its conflict minerals did not originate in the Covered Countries on the basis of information received regarding the remainder of its conflict minerals.

b) *Trigger for Supply Chain Due Diligence Requirement*

Under the proposed rules, an issuer was required to engage in supply chain due diligence unless it could demonstrate that its conflict minerals did not originate in the Covered Countries. Under the final rules, issuers are not required to prove a negative. Instead, an issuer may avoid the supply chain due diligence requirement if, after its reasonable country of origin inquiry it (1) knows that its conflict minerals did not originate in the Covered Countries or that they came from recycled or scrap sources, (2) has no reason to believe its conflict minerals may have originated in the Covered Countries, or (3) reasonably believes its conflict minerals came from recycled or scrap sources. If an issuer cannot make such a determination, it must proceed to the due diligence requirements of step three.

c) *Disclosures in the Specialized Disclosure Report*

If, after conducting the reasonable country of origin inquiry, an issuer is able to make one of the foregoing determinations, then the issuer is not required to conduct due diligence as discussed in step three below. However, the issuer must make certain disclosures in the body of Form SD. In particular, under the "Conflict Minerals Disclosure" heading on Form SD, the issuer must disclose its determination and briefly describe the inquiry it undertook and the results. The issuer also must provide a link to its website where the disclosure is publicly available. Unlike under the proposed rules, the final rules do not require an issuer to provide reviewable business records supporting its conclusion.

E. Step Three: Supply Chain Due Diligence and Conflict Minerals Report

a) *Supply Chain Due Diligence*

The final rules require issuers that (1) know their conflict minerals originated in the Covered Countries and did not come from recycled or scrap sources, or (2) have reason to believe their conflict minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources, to follow a nationally or internationally recognized due diligence framework to determine the source and chain of custody of their conflict minerals. The Organization for Economic Co-Operation and Development's *Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas* ("OECD Guidance"), identified in the adopting release and discussed below, currently is the only such framework.

b) *Results of Due Diligence*

If, at any point during the exercise of due diligence, an issuer determines that its conflict minerals did not originate in the Covered Countries or did come from recycled or scrap sources, the issuer is not required to submit a Conflict Minerals Report. Instead, in its Form SD and on its website, the issuer must disclose its determination and briefly describe its reasonable country of origin inquiry and due diligence efforts and the results.

If, after a reasonable country of origin inquiry and due diligence, an issuer (1) knows that its conflict minerals originated in the Covered Countries and did not come from recycled or scrap sources, or (2) has reason to believe that its conflict minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources, the issuer must provide a Conflict Minerals Report as an exhibit to its Form SD. In the body of the Form SD, the issuer must state that a Conflict Minerals Report is being provided as an exhibit and provide a link to its website where the Conflict Minerals Report is publicly available.

If, instead, an issuer is unable to determine the origin of its conflict minerals or whether its conflict minerals came from recycled or scrap sources, it must provide a Conflict Minerals Report, but, during a transition period, may designate its conflict minerals as "DRC Conflict Undeterminable." This category is discussed further below.

c) ***Temporary DRC Conflict Undeterminable Category***

The proposed rules would have treated issuers that are unable to determine the origin of their conflict minerals in the same manner as issuers that determine that their conflict minerals originated, and financed or benefited armed groups, in the Covered Countries.[2] In response to commentators' concerns regarding the still-developing nature of supply chain tracing mechanisms, the final rules include a transition period for issuers that, after performing due diligence, are unable to determine (1) that their conflict minerals did not originate in the Covered Countries, (2) that their conflict minerals which did originate from the Covered Countries did not directly or indirectly finance or benefit armed groups in the Covered Countries, or (3) that their conflict minerals came from recycled or scrap sources. Such issuers are permitted to describe their products containing such conflict minerals as "DRC Conflict Undeterminable." This category is available for a four-year period for smaller reporting companies and for a two-year period for all other issuers subject to the rules. During this period, an independent private sector audit is not required as part of the Conflict Minerals Report for products that are DRC Conflict Undeterminable.

After this transition period concludes, issuers that are unable to determine that their conflict minerals did not originate in the Covered Countries, that their conflict minerals that originated in the Covered Countries did not directly or indirectly finance or benefit armed groups, or that their conflict minerals came from recycled or scrap sources will be required to describe products in their Conflict Minerals Report as having "not been found to be DRC Conflict Free." Issuers also will be required to provide an independent private sector audit of the Conflict Minerals Report.

d) ***Content of Conflict Minerals Report***

A Conflict Minerals Report for products that are DRC Conflict Free--i.e., products containing conflict minerals that do not directly or indirectly finance or benefit armed groups in the Covered Countries or that contain conflict minerals that are derived from recycled or scrap sources--must include:

- a description of the measures taken to exercise due diligence on the source and chain of custody of the conflict minerals;[3]
- a statement that the issuer obtained an independent private sector audit of the Conflict Minerals Report;[4]
- the audit report prepared by the independent private sector auditor; and
- the identity of the auditor, if it is not included in the audit report.

A Conflict Minerals Report for products that have <u>not</u> been found to be DRC Conflict Free must include:

- a description of the measures taken to exercise due diligence on the source and chain of custody of the conflict minerals;
- a description of the products;

- a description of the facilities used to process the conflict minerals;
- the country of origin of the conflict minerals;
- the efforts undertaken to identify the mine or location of origin with the greatest possible specificity;
- a statement that the issuer obtained an independent private sector audit of the Conflict Minerals Report;
- the audit report prepared by the independent private sector auditor; and
- the identity of the auditor, if it is not included in the audit report.

A Conflict Minerals Report for products that are DRC Conflict Undeterminable, during the temporary transition period, must include all of the information required in a Conflict Minerals Report for products that have not been found to be DRC Conflict Free, as well as a description of the steps the issuer has taken or intends to take to reduce the risk that the conflict minerals contained in its products are benefiting armed groups in the Covered Countries.

e) ***Audit of Conflict Minerals Report***

The Conflict Minerals Report generally must include an independent private sector audit report. The proposed rules left many areas of uncertainty regarding the requirement to obtain an independent audit, including the applicable standards for the required audit and whether the audit concerns an issuer's due diligence process or the conclusions reached in the Conflict Minerals Report. The final rules limit the scope of the audit to the sections of the Conflict Minerals Report that discuss the design of an issuer's due diligence framework and the due diligence measures the issuer performed. In this regard, the final rules set forth a two-fold audit objective. First, the audit must express an opinion regarding whether the design of the issuer's due diligence measures, as set forth in the Conflict Minerals Report, conform with a nationally or internationally recognized due diligence framework. The only such framework currently available is the OECD Guidance. Second, the audit must express an opinion regarding whether the issuer's description of the due diligence measures it performed is consistent with the due diligence process that it, in fact, undertook.

The audit report must be prepared in accordance with existing standards established by the Comptroller General of the United States--specifically, its Government Auditing Standards, commonly referred to as the "Yellow Book." The adopting release states that entities performing an independent private sector audit of the Conflict Minerals Report must comply with independence standards established by the Government Accountability Office, and that retaining the independent public accountant that audits an issuer's financial statements also to perform the audit of the issuer's Conflict Minerals Report would not be inconsistent with those independence standards. However, the adopting release sets forth the SEC's view that the engagement to audit the Conflict Minerals Report would be a "non-audit service" subject to pre-approval requirements of Rule 2-01(c)(7) of Regulation S-X, and the fees related to the audit would need to be included in the "All Other Fees" category of the principal accountant fee required disclosures.

F. Recycled and Scrap Materials

If an issuer determines that its conflict minerals are derived from recycled or scrap sources, rather than from mined sources, the proposed rules would have required the issuer to furnish an audited Conflict Minerals Report stating that its conflict minerals are recycled or scrap and describing the due diligence measures taken in making that determination. The final rules, by contrast, do not require due diligence, or a Conflict Minerals Report, for conflict minerals that an issuer knows or reasonably believes came from recycled or scrap sources. Issuers may describe their products containing conflict minerals from recycled or scrap sources in their required disclosure on Form SD as "DRC Conflict Free."

However, if an issuer initially believes its conflict minerals were from recycled or scrap sources, but, after its reasonable country of origin inquiry, has reason to believe its conflict minerals may not have come from recycled or scrap sources, due diligence is required. Due diligence for such conflict minerals must be exercised in conformity with a nationally or internationally recognized due diligence framework, if such a framework is available. The adopting release acknowledges that currently, the OECD Guidance's "Supplement on Gold" is the only nationally or internationally recognized due diligence framework for any conflict mineral from recycled or scrap sources. If a nationally or internationally recognized due diligence framework becomes available for any of the remaining conflict minerals from recycled or scrap sources prior to June 30 of a calendar year, issuers must use the framework for that conflict mineral in their supply chain due diligence the subsequent calendar year. Until such a framework is available for tracing cassiterite, columbite-tantalite, and wolframite, or their derivatives, that may not have come from recycled or scrap sources, the final rules do not require an independent audit of the Conflict Minerals Report.

G. Stockpiled Minerals

The SEC's proposed rules did not carve out from coverage conflict minerals in an issuer's existing inventory or stockpiles. Given the impracticability of tracing the origin of stocks and products already in existence, issuers would have been required to prepare a Conflict Minerals Report as to their existing inventory of conflict minerals or products containing conflict minerals. The final rules address the issue of stockpiled minerals with a new provision that excludes from coverage any conflict minerals that are "outside the supply chain" prior to January 31, 2013. The final rules consider conflict minerals to be "outside the supply chain" in the following circumstances: (1) after any cassiterite, columbite-tantalite, and wolframite minerals have been smelted; (2) after gold has been fully refined; or (3) after any conflict mineral, or its derivatives, that have not been fully smelted or fully refined are located outside of the Covered Countries.

H. Location of Required Disclosures

Under the proposed rules, conflict minerals disclosures would have been included in an issuer's annual report on Form 10-K, and the Conflict Minerals Report, where required, would have been furnished as an exhibit to the annual report. The final rules require disclosure about conflict minerals to be included in a new Exchange Act form, Form SD, and the Conflict Minerals Report to be provided as an exhibit to Form SD. An issuer also must make its conflict minerals disclosure and its Conflict Minerals

Report, if required, available on its website for one year, and include links to this information in the body of the Form SD.

Form SD is to be filed, rather than furnished. This means that issuers will be subject to liability under Section 18 of the Exchange Act for any "false or misleading" statements in their Form SD, subject to a defense if the issuer acted in good faith and did not have knowledge that the report was false or misleading. The Form SD is not required to be accompanied by the officer certifications that apply to Forms 10-K and 10-Q, and is not incorporated into an issuer's registration statements under the Securities Act of 1933, unless the issuer so specifies.

I. Time Period for Providing Disclosures

While the proposed rules would have treated the date that an issuer took possession of a conflict mineral as determinative of the reporting year in which its conflict minerals disclosures would have been required, under the final rules, an issuer must provide its required conflict minerals information for the calendar year in which the manufacture of a product that contains any conflict minerals is completed.

Issuers that acquire or otherwise obtain control over a company that manufactures or contracts to manufacture products with conflict minerals have additional time under the final rules to file the conflict minerals information if the acquired company previously had not been obligated to make conflict minerals disclosures to the SEC. Such issuers may delay the initial reporting period for the products of the acquired company until the first reporting calendar year that begins no sooner than eight months after the effective date of the acquisition.

Cost of Compliance

The proposed costs of compliance with the conflict minerals rules as set forth in the proposing release were far below what commentators estimated them to be, and, in the final release, the SEC has acknowledged that the costs are expected to be much higher.

The SEC's proposed rules estimated the compliance cost at $71.2 million. By comparison, a Tulane University study estimated the compliance cost of the rules to be $7.93 billion, and the National Association of Manufacturers cited the total cost at $9 billion to $16 billion. As a result of these high cost estimates, the SEC's greater focus on cost-benefit analysis and how various implementations of the rules would affect the cost of compliance factored into its delay in issuing the final rules.

The cost estimates included in the SEC's proposed rules are significantly lower than other suggested estimates because the SEC's figure reflects only the cost to public companies reporting under the rules and does not include the impacts on these companies' suppliers and others in the supply chain that are not reporting companies. In addition, the SEC's estimate that only 20% of affected issuers will be required to prepare a Conflict Minerals Report was likely understated, given that issuers who are unable to determine the origin of their conflict minerals, as well as issuers whose conflict minerals originated in the Covered Countries, will be required to prepare a Conflict Minerals Report. In light of these difficulties with the SEC's cost estimate and the disparity between the SEC's estimate and other

published estimates of the cost of the rules, the U.S. Chamber of Commerce called on the SEC to conduct a new cost-benefit analysis in its July 11, 2012 letter to the agency.

The SEC's release accompanying the final rules estimates the initial compliance costs for issuers to be much greater than the SEC's estimate in the proposed rules: initial costs of approximately $3 billion to $4 billion, with annual ongoing compliance costs of between $207 million and $609 million. The SEC views the burden of this regulatory effort as "necessary and appropriate," though it is expected to create "significant economic effects." The quantified estimates are based on the SEC's economic analysis of data provided by commentators, and the estimate for initial compliance costs attempts to consider: (1) costs for upgrading IT systems; (2) issuers' average number of first-tier suppliers; (3) costs to suppliers; and (4) total number of suppliers affected. Additionally, the SEC estimates that the annual increase in paperwork burden for all affected companies will be approximately 2.2 million hours and $1.2 billion in order to comply with the final rules' collection of information requirements.

OECD Guidance and Supply Chain Tracking Initiatives

A. OECD Guidance

The final rules mandate that conflict minerals supply chain due diligence be performed in accordance with a nationally or internationally recognized due diligence framework. Currently, the OECD Guidance is the only such established framework. The OECD Guidance was adopted as an OECD Recommendation by forty-one countries under the chairmanship of Secretary Clinton, and was designed by the OECD to be "complementary and mutually supportive" of Section 1502. The OECD Guidance has been endorsed by the U.S. Department of State, pursuant to its statutory directive to, in consultation with the Administrator of the U.S. Agency for International Development, "submit to the appropriate congressional committees a strategy to address the linkages between human rights abuses, armed groups, mining of conflict minerals, and commercial products," including "[a] plan to provide guidance to commercial entities seeking to exercise due diligence on and formalize the origin and chain of custody of conflict minerals."

The OECD Guidance includes:

- A supply chain due diligence framework;
- A model supply chain policy;
- Suggested measures for risk mitigation; and
- Two supplements on tin-tantalum-tungsten and gold.

The five-step due diligence framework includes recommendations to enable companies to:

- "Establish strong company management systems;"
- "Identify and assess risks in the supply chain;"

- "Design and implement a strategy to respond to identified risks;"
- "Carry out an independent third-party audit of supply chain due diligence at identified points in the supply chain;" and
- "Report on supply chain due diligence."

The text of the OECD Guidance is available here. The OECD has initiated a pilot program consisting of more than 85 companies and industry associations, including Siemens, Boeing, Ford Motor Company, Hewlett-Packard, and Panasonic.

B. Supply Chain Initiatives

In order for an issuer's due diligence pursuant to the OECD Guidance to provide the information necessary to make disclosures under the rules, traceable and transparent supply chains for conflict minerals must exist. Traceable and transparent supply chains, in turn, require the implementation and establishment of mechanisms that facilitate tracing conflict minerals back to their mine of origin. In this regard, a number of global and in-region supply chain initiatives, discussed in the table included in Appendix II, are under development to enable issuers engaging in due diligence under the OECD framework to obtain the information necessary for making their conflict minerals disclosures. These supply chain tracking initiatives also may facilitate tracing efforts required pursuant to state and foreign regulations relating to the use of conflict minerals.[5]

What Public Companies Should Do Now

Compliance with the conflict minerals rules will entail substantial costs and challenges. While the final rules clarify certain topics raised by commentators and the adopting release provides additional guidance regarding others, many interpretative issues remain, including determining whether an issuer's conduct is considered manufacturing or contract manufacturing, and whether conflict minerals are necessary to the functionality or production of an issuer's products. Similarly, the precise efforts that will be required to conduct reasonable country of origin inquiries and due diligence remains unclear, particularly in light of the still-developing nature of supply chain tracing initiatives. Notwithstanding these areas of uncertainty, issuers should consider taking the following steps to begin this undertaking:

- Determine whether any of your products contain conflict minerals and compile a list of any such products.
- If your products contain conflict minerals, determine whether you are subject to the conflict minerals rules in light of SEC guidance on the meaning of the phrase "necessary to the functionality or production of a product" and the terms "manufacture" and "contract to manufacture."
- If you are subject to the rules, promptly identify your suppliers for products that contain conflict minerals and communicate to those suppliers that their cooperation will be required in order for you to comply with Section 1502.

- Take steps to train relevant employees regarding the conflict minerals rules and best practices for compiling supply chain tracing data from suppliers.

- Adopt processes reasonably designed to determine the country of origin of the conflict minerals used in your products and whether the conflict minerals used in your products are from recycled or scrap sources.

- Determine whether you will require suppliers to provide you with only conflict minerals or products containing conflict minerals that originated outside the Covered Countries.

- Consider developing a Conflict Minerals Policy addressing your position on the sourcing of conflict minerals in your products. Provide the policy to your suppliers, and consider whether to make it publicly available, such as by posting it on your website.

- Consider obtaining representations and warranties concerning the origin of conflict minerals in contracts with your suppliers.

- Coordinate efforts with industry trade associations that have taken an active role in conflict mineral supply chain tracing efforts and compliance, such as the Electronic Industry Citizenship Coalition ("EICC").

- Adopt due diligence processes to determine the chain of custody of the conflict minerals used in your products:

    - Familiarize yourself with the Conflict-Free Smelter Program, developed by the EICC and Global e-Sustainability Initiative ("GeSI") Work Group, which makes it possible to identify smelters that can demonstrate through an independent audit that materials they procure did not originate from sources that contribute to conflict in the Covered Countries.[6]

    - Consider using the Conflict Minerals Reporting Template, created by the EICC and GeSI Work Group, for compiling sourcing information on tantalum, tin, tungsten, and gold used in your products.[7]

- Design, maintain, and regularly evaluate disclosure controls and procedures designed to ensure timely recording, processing, summarizing, and reporting of the information required by the conflict minerals rules through communication of relevant information to the appropriate employees and suppliers.

- Develop and implement controls that document your analysis of whether you manufacture or contract to manufacture products containing conflict minerals necessary to the functionality or production of the products, your reasonable country of origin inquiry and your due diligence processes, if applicable.

- Consider the independent private sector auditor you would retain if required.

[1] As an example, the adopting release provides that if a conflict mineral is necessary to either "making and receiving phone calls, accessing the internet, [or] listening to stored music," it would be necessary to the functionality of a smartphone with all of those capabilities.

[2] The term "armed group" is defined to mean an armed group that is identified as a perpetrator of serious human rights abuses in annual Country Reports on Human Rights Practices under the Foreign Assistance Act of 1962.

[3] The adopting release states that if an issuer's due diligence process is relatively consistent throughout its supply chain, the issuer can satisfy this requirement by generally describing its due diligence. But, if an issuer exercises significantly different due diligence processes for different aspects of its supply chain, such as for different conflict minerals or products, the issuer should describe how the processes are different.

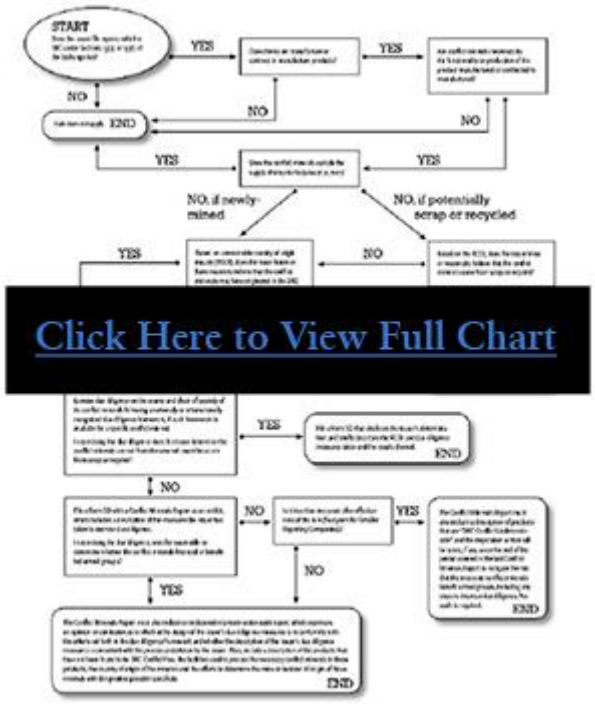
[4] This statement constitutes the issuer's certification of the audit as required by Section 1502. The adopting release is clear that the statement need not be signed by an officer of the issuer.

[5] Conflict minerals legislation was adopted in California in October 2011 and in Maryland in May 2012. Other states considering similar legislation include Massachusetts and Rhode Island.

[6] The EICC and GeSI Work Group represent over 80 companies in the electronics and information and communications technologies industry. The list of compliant smelters and refiners is available here.

[7] The Conflict Minerals Reporting Template is available here.

APPENDIX I



Source: Adopting Release.

APPENDIX II

Stakeholder-Developed Global and In-Region Sourcing Initiatives					
Initiative	**Primary organizations involved**	**Purpose**	**Participation type**	**Independent audit required**	**Status of initiative**
Global initiatives					
OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas [website]	Organisation for Economic Co-Operation and Development (OECD)	Establishes practical guidance to enable companies to responsibly operate in and source from conflict areas and promotes accountability and transparency in conflict minerals supply chains.	Voluntary	Yes	Implementation phase
UNGoE Due Diligence Guidelines [website]	United Nations Group of Experts (UNGoE) on the DRC	Establishes practical guidance to enable companies to responsibly operate in and source from conflict areas	Mandatory	Yes	Implementation phase

Stakeholder-Developed Global and In-Region Sourcing Initiatives					
Initiative	**Primary organizations involved**	**Purpose**	**Participation type**	**Independent audit required**	**Status of initiative**
		and promotes accountability and transparency in conflict minerals supply chains.			
Conflict-Free Smelter Program [website]	Global e-Sustainability Initiative (GeSI); Electronic Industry Citizenship Coalition (EICC)®	Verifies that the sources of conflict minerals processed by smelters are conflict-free. Enables downstream companies to identify and source from conflict-free smelters.	Voluntary	Yes	Implementation phase
WGC Conflict-Free Gold Standard and Tools [website]	World Gold Council (WGC)	Establishes a common approach for mining companies to responsibly mine gold and	Voluntary	Yes	Development phase

Stakeholder-Developed Global and In-Region Sourcing Initiatives					
Initiative	**Primary organizations involved**	**Purpose**	**Participation type**	**Independent audit required**	**Status of initiative**
		demonstrates that their mining operations do not fuel conflict or the abuse of human rights.			
LBMA Responsible Gold Guidance [website]	London Bullion Market Association (LBMA)	Ensures that all gold feed stock and all gold produced by refiners are conflict-free. Enables downstream companies to identify and source from conflict-free refiners.	Mandatory for LBMA accredited refiners	Yes	Development phase
RJC Chain-of-Custody Certification Program [website]	Responsible Jewellery Council (RJC)	Supports the identification and tracking of conflict-free gold throughout gold supply	Voluntary	Yes	Implementation phase

Stakeholder-Developed Global and In-Region Sourcing Initiatives					
Initiative	**Primary organizations involved**	**Purpose**	**Participation type**	**Independent audit required**	**Status of initiative**
		chains with the transfer of chain-of-custody documentation.			
In-region sourcing initiatives					
ITRI Tin Supply Chain Initiative (iTSCi) [website]	ITRI; Tantalum Niobium International Study Center; Pact; Channel Research	Supports responsible sourcing from Central Africa through the development of (1) a physical chain-of-custody system that tracks and monitors minerals from mine to smelter and (2) a due diligence system that includes independent audits and mine site and transportation route assessments.	Voluntary	Yes	Implementation phase

Stakeholder-Developed Global and In-Region Sourcing Initiatives					
Initiative	**Primary organizations involved**	**Purpose**	**Participation type**	**Independent audit required**	**Status of initiative**
Certified Trading Chains [website]	German Federal Institute for Geosciences and Natural Resources (BGR)	Supports responsible sourcing from Central Africa through the creation of a certification framework for artisanal mining sites.	Voluntary	Yes	Implementation phase
ICGLR's Regional Certification Mechanism	International Conference on the Great Lakes Region (ICGLR)	Establishes a certification mechanism for the mining and trading of conflict minerals from the Great Lakes Region.	Mandatory for member countries	Yes	Development phase
Source: "Conflict Minerals Disclosure Rule: SEC's Actions and Stakeholder-Developed Initiatives," Report to Congressional Committees, United States Government Accountability Office, Table 2: Stakeholder-Developed Global and In-Region Sourcing Initiatives, 17-18 (July 2012), available here.					

This Client Alert was posted on the date the rules were adopted as a blog on the Gibson Dunn Securities Regulation and Corporate Governance Monitor, available at https://securitiesregulationmonitor.com. We encourage you to sign up at the Monitor website to receive email alerts when we post information on developments and trends in securities regulation, corporate governance and executive compensation.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have about these developments. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you work, or any of the following lawyers:

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