SEC Issues Long-Delayed Rule on Conflict Minerals

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On August 22, 2012, the Securities and Exchange Commission voted 3-2 in favor of a final rule covering disclosures by public companies with respect to so-called "conflict minerals."

The final 356-page rule can be found here and will be effective 60 days after publication in the Federal Register.

Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act was intended to address concerns that the sourcing of certain minerals is supporting the ongoing conflict in the Democratic Republic of Congo ("DRC"). The statute directed the SEC to issue rules defining specific disclosure requirements for issuers for which conflict minerals are "necessary to the functionality or production of a product" manufactured, or contracted to be manufactured, by the issuer. Conflict minerals consist of columbite-tantalite (tantalum), wolframite (tungsten), cassiterite (tin), and gold.

The SEC released proposed rules in December 2010, which generated considerable debate about the expected costs of compliance as well as the efficacy of using disclosure requirements to address human rights concerns. The SEC had been required to issue final rules by April 2011, and thus this rule-making is long overdue.

Key requirements and features of the final rules are summarized below:

General Requirements – Due Diligence

Issuers that utilize conflict minerals must conduct a reasonable country of origin inquiry designed to establish whether the identified "conflict minerals" may have originated in the DRC or adjoining countries (the "Covered Countries") or are from recycled or scrap sources.

If, after a good faith inquiry, an issuer utilizing conflict minerals determines, or has reason to believe, that those minerals were newly mined in the Covered Countries, then the issuer must conduct due diligence on the source and chain of custody of those minerals. This due diligence should follow a nationally or internationally recognized framework, if such a framework is available for the mineral(s) in question. The SEC notes in the final rule release that the due diligence guidance provided by the OECD (Organization for Economic Co-operation and Development) is currently the only nationally or internationally recognized due diligence framework for the covered conflict minerals.

General Requirements – Results of Due Diligence

If an issuer determines that the conflict minerals originated outside the Covered Countries, or are from recycled or scrap sources, the issuer must file a Form SD (newly adopted by the SEC) describing its reasonable country of origin inquiry, its due diligence efforts, the results of its due diligence efforts, and its conclusions. No "Conflicts Minerals Report" or other action is required.

Otherwise, the issuer must file a Form SD, with a Conflict Minerals Report as an attached exhibit, containing:

- a description of its due diligence efforts,
- a description of any products found not to be "DRC Conflict Free," and the facilities used to process the conflict minerals used in those products,
- the country of origin of those conflict minerals, and

- a description of efforts taken to locate the mine or location of origin of those conflict minerals with the greatest possible specificity.

Independent Audit of Conflict Minerals Report

A Conflict Minerals Report must also include an independent private sector audit report expressing an opinion or conclusion as to whether the issuer's due diligence conforms with the criteria in the applicable due diligence framework and whether the issuer's description of its due diligence measures is consistent with its actual efforts.

Transition Period

There is a two-year transition period for issuers during which they may be eligible to describe their products as "DRC conflict undeterminable." The transition period is four years for issuers that meet the SEC's existing definition of smaller reporting companies. An issuer may use the "DRC conflict undeterminable" designation if:

- it knows, or has reason to believe, that it utilizes conflict minerals that originated in the Covered Countries and, after conducting due diligence, the issuer is unable to determine whether those conflict minerals financed or benefited armed groups; or
- it has reason to believe that the conflict minerals may have originated from the Covered Countries and may not have come from recycled or scrap sources and, after due diligence, it is unable to determine the country of origin of the conflict minerals, whether those conflict minerals financed or benefited armed groups, or whether the conflict minerals came from recycled or scrap sources.

Note : Issuers with products that may be described as "DRC conflict undeterminable" must still file a Conflict Minerals report, but the report does not need to be audited.

Filing with the SEC

Issuers subject to the rule must file a Form SD and, if applicable, the attached Conflict Minerals Report under the Securities Exchange Act. This means that issuers are subject to potential liability under Section 18 of the Exchange Act for false and misleading statements.

No De Minimis Exemption

The final rules do not contain an exemption for issuers that utilize only small amounts of the covered conflict minerals.

Effective Dates

The final rules will be effective 60 days after publication in the Federal Register. Issuers subject to the rules must comply beginning on January 1, 2013. Reports issued pursuant to the final rules must cover the calendar year (January 1 to December 31) with reports due on May 31 of the following year. The first reports are therefore due on May 31, 2014.

Issuers that utilize conflict minerals are exempted from the rules if those minerals are "outside the supply chain" prior to January 31, 2013. "Outside the supply chain" is defined as minerals that have been smelted or fully refined or, if not smelted or fully refined, if those minerals are outside the Covered Countries.

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Many observers expect business groups to challenge the final rule in court. When the SEC promulgated rules mandating proxy access, a successful lawsuit to enjoin those rules was brought by the Business Roundtable and the United States Chamber of Commerce. However, the proxy access rules were developed on the SEC's initiative, without Congressional involvement. In contrast, the conflict minerals rules were promulgated at the direction of Congress and may therefore be more resistant to attack.

Future alerts will discuss the conflict minerals rules in more detail.

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