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SEC Adopts Conflicts Minerals Rule

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The Securities and Exchange Commission has adopted rules pursuant to Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to the use of conflict minerals. Section 1502 was enacted because of concerns that the exploitation and trade of conflict minerals by armed groups is helping to finance conflict in the Democratic Republic of the Congo ("DRC") or an adjoining country (together with DRC, the "covered countries"). Section 1502 added Section 13(p) to the Securities Exchange Act of 1934 which directs the SEC to issue rules requiring certain companies to disclose their use of "conflict minerals" if those minerals are "necessary to the functionality or production of a product" manufactured by those companies or contracted by those companies to be manufactured. The new rule takes effect on November 13, 2012.

Conflict Minerals

The rule relates to the use by covered companies of "conflict minerals" which are defined in the rule as cassiterite, columbite-tantalite, gold, wolframite, and their derivatives tantalum, tin, and tungsten, and any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the covered countries.

Companies Subject to the Rule

The rule applies to all companies that file reports with the SEC under Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 for which conflict minerals are necessary to the functionality or production of a product manufactured or contracted by that issuer to be manufactured. The rule does not exempt foreign private issuers or smaller reporting companies.

Whether a company is considered to be contracting to manufacture a product depends on the degree of influence it exercises over the materials, parts, ingredients, or components to be included in any product that contains conflict minerals or their derivatives. The SEC does not believe that the following actions by themselves constitute contracting to manufacture a product: (i) specifying or negotiating contractual terms with a manufacturer that do not directly relate to the manufacturing of the product unless the company specifies or negotiates taking these actions so as to exercise a degree of influence over the manufacturing of the product that is practically equivalent to contracting on terms that directly relate to the manufacturing of the product; (ii) affixing its brand, marks, logo, or label to a generic product manufactured by a third party; or (iii) servicing, maintaining, or repairing a product manufactured by a third party.

In determining whether its conflict minerals are "necessary to the functionality" of a product, a company must consider: (a) whether a conflict mineral is contained in and intentionally added to the product or any component of the product and is not a naturally-occurring by-product; (b) whether a conflict mineral is necessary to the product's generally expected function, use, or purpose; or (c) if a conflict mineral is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration.

In determining whether a conflict mineral is "necessary to the production" of a product, a company must consider: (a) 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); (b) whether the conflict mineral is included in the product; and (c) whether the conflict mineral is necessary to produce the product. For a conflict mineral to be considered "necessary to the production" of a product, the mineral must be both contained in the product and necessary to the product's production.

Analytical and Disclosure Framework

Each company must engage in a multi-step analysis to determine whether and what it is required to disclose regarding its conflict minerals:

Step 1-Necessary to the Functionality or Production of a Product.

a. A company must determine whether it is subject to the requirements of the rule (i.e. whether it meets the definition of a subject company outlined above).

b. If a company is not subject to the rule, it is not required to take any action or make any disclosures.

Step 2-Country of Origin Determination

c. If a company is subject to the rule, it must conduct in good faith a reasonable country of origin inquiry reasonably designed to determine whether any of its conflict minerals originated in any of the covered countries or are from recycled or scrap sources.

d. If the company determines that its conflict minerals did not originate in a covered country or did come from recycled or scrap sources, or if it has no reason to believe that its conflict minerals may have originated in a covered country, or the company reasonably believes that its conflict minerals did come from recycled or scrap sources, it must disclose its determination in Form SD (see below), briefly describe the reasonable country of origin inquiry it used in reaching the determination and the results of the inquiry and make the information publicly available on its website and provide the internet address of that site.

Step 3-Due Diligence and Conflict Minerals Report

e. If a company knows that any of its conflict minerals originated in a covered country and are not from recycled or scrap sources, or has reason to believe that its necessary conflict minerals may have originated in a covered country and has reason to believe that they may not be from recycled or scrap sources, it must exercise due diligence on the source and chain of custody of its conflict mineral that conforms to a nationally or internationally recognized due diligence framework.

f. If the company determines that its conflict minerals did not originate in a covered country or it determines that its conflict minerals did come from recycled or scrap sources, it is not required to prepare a Conflict Minerals Report but must disclose its determination in Form SD and briefly describe the reasonable country of origin inquiry and the due diligence efforts it undertook and make this information publicly available on its website and provide the internet address of that site.

g. If the company determines that its conflict minerals did originate in a covered country or it is unable to determine that its conflict minerals came from recycled or scrap sources, it must file a Conflict Minerals Report as an exhibit to its Form SD and provide that report on its publicly available website.

Reasonable Country of Origin Inquiry

The inquiry depends on the company's facts and circumstances at the time and the rule does not prescribe specific actions that are required in a reasonable country of origin inquiry. As a general rule, the inquiry regarding the origin of a company's necessary conflict minerals must be reasonably designed to determine whether any of the conflict minerals originated in the covered countries or are from recycled or scrap sources, and must be performed in good faith.

The adopting release expressly states that a company satisfies the reasonable country of origin inquiry standard if it seeks and obtains reasonably reliable representations either from the facility or the company's immediate suppliers indicating the facility at which its conflict minerals were processed and demonstrating that those conflict minerals did not originate in the covered countries or came from recycled or scrap sources. The company must have a reason to believe these representations are true given the facts and circumstances (for example, if a processing facility received a "conflict-free" designation by a recognized industry group that requires an independent private sector audit of the smelter) and must also take into account any applicable warning signs.

The company is not required to receive representations from all of its suppliers. If a company reasonably designs an inquiry and performs the inquiry in good faith, it may conclude that its conflict minerals did not originate in the covered countries, even though it does not hear from all of its suppliers, as long as it does not ignore warning signs or other circumstances indicating that the remaining amount of its conflict minerals originated or may have originated in the covered countries.

Due Diligence

A company must exercise due diligence on the source and chain of custody of its conflict minerals and provide a Conflict Minerals Report (as described below) if, based on its reasonable country of origin inquiry, the company 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.[1]

[1] If, at any point during the exercise of due diligence, the company determines that its conflict minerals did not originate in the covered countries or came from recycled or scrap sources, the issuer is not required to submit a Conflict Minerals Report or obtain an independent private sector audit. However, the company, is still required to submit a Form SD disclosing its determination and briefly describing the reasonable country of origin inquiry and the due diligence efforts it exercised and the

The company's due diligence must conform to a nationally or internationally recognized due diligence framework, if such a framework is available for the conflict mineral, and include an independent private sector audit of the Conflict Minerals Report conducted in accordance with standards established by the Comptroller General of the United States. The purpose of the audit is to express an opinion as to whether the design of the company's due diligence measures conforms with the due diligence framework used by the company, and whether the company's description of the due diligence measures it performed as described in the Conflict Minerals Report is consistent with the process that the company undertook.

Conflict Minerals Report

If a company determines that its products are "DRC conflict free," which means that the conflict minerals in those products may have originated from the covered countries but did not finance or benefit armed groups in those countries, the Conflict Minerals Report must include the following information:

- a description of the company's due diligence measures on the source and chain of custody of the conflict minerals;

- a statement that the company has obtained an independent private sector audit of the Conflict Minerals Report, and certify that it has obtained such an audit;

- include the audit report as part of the Conflict Minerals Report and identify the independent private sector auditor, if the auditor is not identified in the audit report;

If the company determines that it manufactures products or contracts for products to be manufactured that have not been found to be "DRC conflict free," then in addition to the information required above, it must also include in the Conflict Minerals Report a description of those products, the facilities used to process the necessary conflict minerals in those products, the country of origin of the conflict minerals in those products, and the efforts to determine the mine or location of origin with the greatest possible specificity.

During a transition period of the first two calendar years following effectiveness of the rule (the first four calendar years for any smaller reporting company), a company may describe its products as "DRC conflict undeterminable."[2] The company will not be required to submit an audit report of its Conflict Minerals Report with respect to the conflict minerals in any of its products. However, during such period the company must describe its due diligence measures on the source and chain of custody of the conflict minerals, provide a description of those products, the facilities used to process the necessary conflict minerals in those products, if known, the country of origin of the necessary conflict minerals in those products, if known, and the efforts to determine the mine or location of origin with the greatest possible specificity, the steps it has taken 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.

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results of the inquiry and due diligence efforts to demonstrate why the issuer believes that the conflict minerals did not originate in the covered countries or came from recycled or scrap sources.

[2] The term "DRC conflict undeterminable" means that the company is unable to determine, after exercising due diligence whether or not such product qualifies as DRC conflict free.

A company that is required to provide a Conflict Minerals Report is required to disclose in its Form SD, under a separate heading entitled "Conflict Minerals Disclosure," that a Conflict Minerals Report is provided as an exhibit and to disclose a link to its website where the Conflict Minerals Report is publicly available.

Independent Private Sector Audit

The independent private sector audit of the Conflict Minerals Report must be conducted in accordance with standards established by the Comptroller General of the United States and certified. The purpose of the audit is to express an opinion as to whether the design of the due diligence measures described in the Conflict Minerals 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 company, and whether the company's description of the due diligence measures it performed as described in the Conflict Minerals Report is consistent with the due diligence process that the company undertook.

Recycled and Scrap Sources

There are special rules for recycled and scrap sources. If a company's conflict minerals are derived from recycled or scrap sources rather than from newly-mined sources, the company's products containing such minerals are considered "DRC conflict free."

If a company reaches this conclusion based on its reasonable country of origin inquiry, it is not required to exercise due diligence or file a Conflict Minerals Report regarding those minerals. However, it must disclose its reasonable country of origin inquiry determination and provide a brief description of the reasonable country of origin inquiry it undertook and the results of its inquiry in its Form SD. It must also disclose this information on its website and provide the internet address of the site in the Form SD.

A company that cannot reach this conclusion based on its reasonable country of origin inquiry is required to undertake due diligence in accordance with a nationally or internationally recognized due diligence framework, and obtain an audit of its Conflict Minerals Report. Currently, gold is the only conflict mineral with a nationally or internationally recognized due diligence framework for determining whether it is recycled or scrap, which is part of a separate gold supplement to the OECD Due Diligence Guidance.

For the other three conflict minerals, until a nationally or internationally recognized due diligence framework is developed for those minerals, the company is required to describe the due diligence measures it exercised in attempting to determine that its conflict minerals are from recycled or scrap sources. However, it is not required to obtain an independent private sector audit of its Conflict Minerals Report for those conflict minerals.

Form SD

Covered companies must provide the conflict minerals information in a specialized disclosure report on new Form SD. The conflict minerals information provided in Form SD, including any Conflict Minerals Reports and independent private sector audit reports, are deemed "filed" rather than "furnished" under the Exchange Act. A company will be subject to liability under Section 18 of the Exchange Act for any "false or misleading" statements in their Form SD unless it can establish that it acted in good faith and had no knowledge that the statement was false or misleading.

The Form SD must be filed for every calendar year from January 1 to December 31 (regardless of any fiscal year end) and will be due on May 31 of the following year. In addition, the company must make its conflict minerals disclosure or its Conflict Minerals Report available on its Internet website for one year.

Companies subject to the rule must make the required disclosures regarding their conflict minerals on a calendar year basis by May 31 of the subsequent year. New public companies must make the required disclosure for the first calendar year that begins eight months or more after the effective date of the registration statement for its initial public offering.

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Please contact Paul De Rosa by phone at (412) 297-4821 or by e-mail at pderosa@cohenlaw.com or Christie Tillapaugh by phone at (412) 297-4603 or by e-mail at ctillapaugh@cohenlaw.com for further information or if you have any questions concerning this topic.