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Conflict Minerals Compliance

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Conflict Minerals Rule Casts a Wide Shadow

By Reese Darragh

At first blush, the Securities and Exchange Commission's new rules requiring increased disclosures on the use of "conflict minerals" seemed fairly esoteric. After all, it applied to companies that use such rare metals as cassiterite, columbite-tantalite, and wolframite. But as they take a closer look, many companies in various industries are finding that the regulation could place a hefty compliance burden on them.

Consider Kraft Foods, hardly the type of manufacturing company that Congress likely had in mind when it put the rule into the Dodd-Frank Act in 2010. Kraft discovered that some of its packaging, promotional materials, and factory equipment contain trace amounts of the four metals named in the rule. As the rule is currently written, Kraft says it could be obligated to track as many as 100,000 suppliers for thousands of products to comply with the law. "We had no idea this legislation was going to be covering companies like us," said Kraft's Irma Villarreal, chief securities counsel and assistant corporate secretary, during an SEC forum on the proposed rule. "Respectfully this is not something we can turn on a dime and start doing ... It is going to take us some time. We don't have the ability to talk to 100,000 suppliers to ensure what and who has conflict minerals," she said.

Kraft is not alone. Many companies say they were blindsided by the scope of the rule, and many more may not even yet realize that the presence of the minerals in their supply chain, however minute, could create a huge compliance requirement.

"This is a sleeper issue with a huge segment of manufacturing and retail companies not prepared for it. They think that the rule only applies to mining and metal," says Jane Luxton, a partner at law firm Pepper Hamilton. Not so. Luxton says many of the companies she advises are finding it difficult to believe that they will be subjected to the rule.

The conflict minerals rule will require companies to report whether they or their suppliers obtain any of four metals—gold, wolframite (a source of tungsten), cassiterite (the main source of tin), and columbite-tantalite, which is also known as coltan and is used in consumer electronics and computer chips—from the Democratic Republic of Congo or neighboring countries. The objective of the provision is to add transparency to the market, which is alleged to fuel violence and human rights abuses in the war torn area.

"This part of the world has been one of the most dead-

SEC Issues New Guidance on Conflict Minerals Rules

By Joe Mont

With less than a year to go until the first disclosure reports on the use of "conflict minerals" are due on May 31, 2014, the Securities and Exchange Commission has issued fresh guidance, clarifying the disclosure requirements for minerals used in packaging. The SEC also better defined what is meant by "contracting to manufacture."

The latest guidance was published by the SEC's Division of Corporation Finance in the form of "frequently asked questions." Among the scenarios addressed was what exactly was considered packaging, which is exempted from the rule. The SEC explained that if the package or container is considered necessary to the functionality of the accompanying product than it would be subject to the rules. The packaging or container sold with a product is not considered to be part of it, as it is generally discarded, and therefore not subject to the requirements. This holds true even if the packaging is necessary to preserve its usability up to and following purchase, the SEC said. If, however, an issuer independently manufactures and sells packaging or containers they would then be considered a product.

In August 2012, the Commission issued a final rule specifying how companies must report the use of certain minerals—including tin, tantalum, tungsten, and gold—mined in the war-torn Congo region of Africa and often used to fund violent militia groups. The rule, a mandate of the Dodd-Frank Act, requires companies to determine and disclose the source country of those minerals. A Reasonable County of Origin Inquiry is required, with disclosure of this assessment detailed in the SEC's new Form SD.

The SEC also detailed the meaning of "contract to manufacture," which is covered by the rules. An issuer is not considered to be "contracting to manufacture," the SEC wrote, if a generic product if its actions involve nothing more than "affixing its brand, marks, logo, or label to a generic product manufactured by a third party." Etching or otherwise marking a generic product manufactured by a third party with a logo, serial number, or other identifier is not considered to be "contracting to manufacture."

The first conflict minerals disclosures are due on May 31, 2014.

NOTE: Some of the articles in this report were prepared before this guidance was issued by the SEC.

ly on earth," U.S. Senator Dick Durbin (D-Ill.) said at an SEC roundtable. "Our demand for products that contain these minerals could inadvertently be fueling this war." Durbin was one of the provision's authors.

Tom Quaadman, vice president of capital markets at the U.S. Chamber of Commerce, says most businesses are busy with their operations and they are not necessarily closely following the developments of the rule. "I think that more members are now becoming aware of the potential issues that the conflict minerals provision may pose to them," he says.

To comply with the due diligence process under the conflict minerals rule can be difficult, especially for large companies like Kraft. The rule contains a three-step process that companies must follow to determine if they are covered by the rule. The initial step involves conducting due diligence to determine if they use any of the minerals in their production.

Next, companies must make substantial inquiry from their suppliers on the origin of minerals used in their supply chain. If they can conclude decisively that the metals used are not sourced from the DRC, companies can then disclose the information in the body of their annual report and submit the methodologies they have used to confirm the origination of the minerals.

Any companies that cannot conclude decisively the origin of such minerals must include their findings in their annual reports. In addition, they have to furnish a separate conflict minerals report in a new Form SD and have the report reviewed by independent auditors.

No Exceptions

The main issue with the rule and the source of most of the frustration voiced by companies at the roundtable is that the rule does not provide for exemptions for companies that use minute amounts of the minerals in question, known as a de minimis exception. The *de minimis* provision would exempt companies with final goods containing less than five percent traces of those minerals from the reporting requirement. "*De minimis* is a must. Without it, there will be a high number of companies pulled into this [Conflict Minerals Rule]," says Kevin Petrasic, a partner at law firm Paul Hastings. Without the exception, he says there will be many instances where companies performed their due diligence in good faith but missed an aspect of its production which contained traces of those minerals.

Schneider Electric, a global energy solutions upstream supplier for many of the Fortune 1000 companies says there will be instances where they cannot supply the required information to their clients.

Jeff Masson, senior vice president of purchasing North America at Schneider, says he is concerned with the expected level of detail the SEC plans to require. "We are looking at our supply chain to determine the best way of obtaining the information necessary for our customers. Many of our large global suppliers are aware and prepared for the rule. However, most of our small to medium size suppliers are just starting to look at the regulation. In many cases, they don't have the internal competencies to understand the requirements and will likely struggle to comply," he says.

Masson adds some of the minerals used in the production are so minuscule that attempting to verify their origin is a significant undertaking as the minerals may come from numerous suppliers.

Quaadman says businesses are concerned about the potential inability to trace the source of minerals that may have been smelted or used in trace amounts. The process is likely to increase costs of compliance and raw materials. There are concerns that the due diligence process will affect companies' long-term raw materials acquisitions. "Obviously, this rule has harmful economic and job creation consequences that were not initially contemplated by regulators," he says.

Cost to Comply

The SEC projected the rule to affect 6,000 companies at the cost of $71 million. The U.S. Chamber of Commerce puts the scope and cost of the rule much higher. It says it estimates that the rule will affect tens of thousands of businesses and the cost will topple $16 billion. A recent study by Tulane University Law School put the aggregate cost to comply at $7.9 billion.

Meanwhile, the U.S. Small Business Administration proposed a re-evaluation of the Commission's initial study on the impact of the rule to small businesses. In its comment letter to the SEC, the SBA said the SEC's initial analysis dismissed the costs of compliance to small businesses, defining it as "difficult to assess but are likely insignificant." A legal challenge to the rule has been filed by the Chamber and industry groups and is still pending.

"Because the SEC does not take into account the complexity of supply chains and the number of small businesses that are part of those supply chains," the SBA said in the letter, "the SEC has underestimated the number of small businesses that would be impacted by the proposed rule." ■

Time to Get Started

By Barbara Kipp

What are conflict minerals?

In August 2012, the SEC approved its final rule on conflict minerals. The rule, mandated by the Dodd-Frank Act, requires public companies to disclose whether they use conflict minerals (tantalum, tin, tungsten, and gold) and whether the minerals originated in the Democratic Republic of the Congo (DRC) or adjoining countries (covered countries). It addresses concerns that conflict minerals mined in covered countries help finance armed groups that are responsible for violence in those countries. The disclosures are intended to promote the strengthening of custody controls surrounding conflict minerals and thereby reduce funding for the armed groups.

Conflict minerals can be found in hundreds of products ranging from cell phones and laptop computers to jewelry, golf clubs, drill bits, and hearing aids. Due to this widespread use, an estimated 6,000 companies that are SEC issuers will have to provide new disclosures under the rule. Approximately another 275,000 private companies that are part of the issuers' supply chains are also affected. The SEC estimates compliance costs at $3 to $4 billion initially and over $200 million annually thereafter.

Companies must first comply with the disclosure requirements on May 31, 2014, for 2013 calendar year operations. An issuer that is unable to determine whether its conflict minerals are conflict free is allowed a temporary two-year period (four years for smaller companies) to describe its minerals as "DRC conflict undeterminable." During that temporary period, however, the issuer is still required to perform due diligence and file an unaudited Conflict Minerals Report (CMR) with additional disclosures, including steps taken to improve due diligence and mitigate the risk that its conflict minerals benefit armed groups.

This means that companies should act now to prepare for the 2014 disclosure requirements. But companies have many open questions as to what the new rules mean to them and how they can comply with the rules. This article is intended to assist companies in getting started by taking a practical approach, identifying components of a compliance program, and reviewing some considerations for success based on our observations.

Getting started

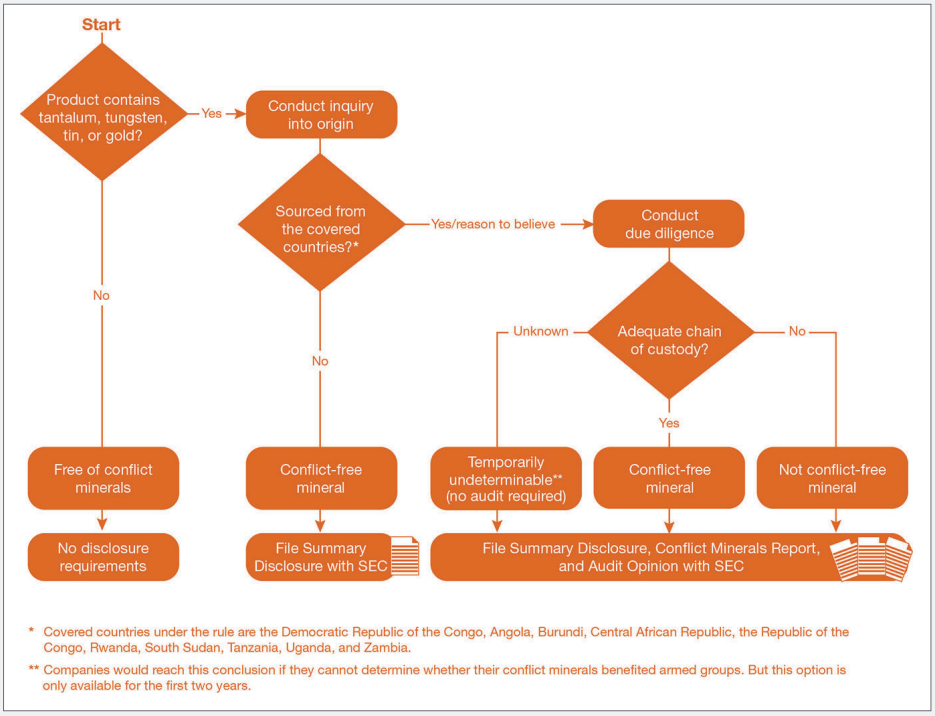
There are clearly challenges to adhering to the SEC requirements, but companies can take a proactive approach. They should consider how they will ascertain which products may be affected by the rules, navigate the complexity of their supply chains to determine whether their products are conflict free, and leverage other industry efforts to increase collaboration and reduce the burden of compliance.

To assist with understanding the SEC requirements, the ruling can be summarized in a decision tree (below) with a few possible outcomes, each carrying unique challenges.

Based on the decision tree outcomes, companies can determine the next steps to ensure compliance with the SEC rules. Once a company determines that S1502 applies, stakeholders can begin to identify how the requirements will impact the company. The SEC requires companies to:

1. Examine their products to determine whether and to what extent Section 1502 applies;
2. If applicable, perform reasonable country of origin inquiry (RCOI) to determine whether minerals are sourced from covered countries; and
3. If applicable, perform due diligence

Conflict minerals decision tree



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and report (e.g., Form SD, CMR, independent private sector audit)

What a conflict minerals program looks like

Given the complexity of the new rules, many companies are not sure where to start or how to break down the rules into actionable items. The best approach is to view the rules as three main tasks. First, determine product and supplier scope. Next, understand the source of minerals and chain of custody. Finally, report on conflict mineral status. A practical approach, as illustrated in the following figure, that is well planned out and easy to comprehend, can help companies navigate the ruling.

A successful conflict minerals program consists of various moving parts. By referring to the framework illustrated below, companies can begin to identify any gaps in their programs. Once companies determine where they are within the program, they can carefully plan an approach to address the breadth of Dodd-Frank Section 1502 requirements.

Considerations for a successful conflict minerals program

For many companies, compliance will be the sole objective; others may want to capitalize on the opportunity to drive value in the supply chain. Based on our experience, the following are some considerations that contribute to a successful program.

Take a broader view by focusing on your customers, and determine how compliance may add value

» Market expectations will change, and stakeholders may ultimately compare companies' information. Those stakeholders will influence the market importance of conflict status, and companies that get ahead of the rules and move quickly to become "conflict-free" may enjoy competitive advantage.

» While companies may not agree with or approve of this rule, they may be able to drive value from their compliance efforts. New sourcing initiatives could contribute to improved corporate alignment or ethical sourcing; sustainable supply chain efforts could lead to reputational advantages.

Develop your philosophy; set goal posts

» Establishing a comprehensive conflict minerals compliance philosophy from the initiative's onset will provide a guiding light for your compliance program and a basis for your conflict minerals policy. Development of the company's policy statement is critical, as it becomes the basis for internal and external stakeholder expectations and setting of responsibilities. Where the philosophy becomes the guidance, the policy becomes the implementation roadmap.

Take a phased approach: Start sooner than later, and take advantage of the transition period

» Develop and sequence your implementation roadmap logically and realistically based on available resources. Following a practical and phased method while leveraging any one of several risk-based approaches will be important. While meeting annual requirements, a multi-year approach that leverages evolving industry and regional developments can help the company progress.

Dedicate resources to successful program execution

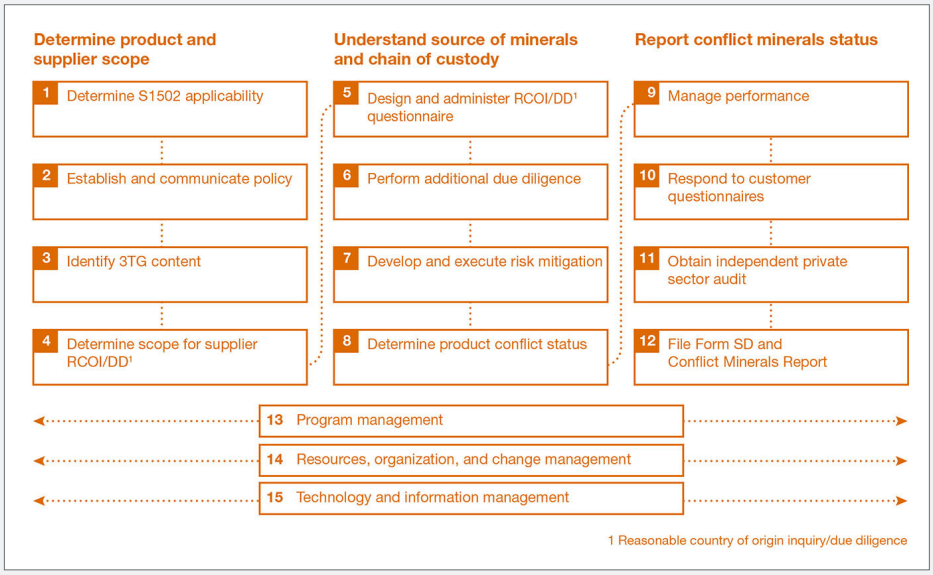
» Conflict minerals compliance requires a coordinated effort among various functions across the company. Effective orchestration by the program manager will maximize each function's contribution so that skills, experiences, and knowledge are leveraged but invested time is minimized.

» Selection of the company's executive officer who will sign the Form SD is an important activity as he or she will set the tone for this initiative's success; they usually become the executive sponsor.

Leverage other efforts where applicable

» Leverage existing compliance or supply chain visibility-enhancing initiatives

PwC's framework for S1502 compliance, based on OECD guidance & SEC requirements



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(REACH, RoHS, etc.), as many program requirements are similar. Your goal should be to have one established backbone architecture where additional requirements may attach; new legislative requirements should not always necessitate a new program.

Focus on supplier engagement early and often throughout the program

» By engaging with your suppliers early, even those who may not be contacted for further due diligence, you are communicating your company's compliance intentions well in advance of any formal or informal requests for information.
» The actions of the external supplier population will dictate how successful your initiative will be. You will not be able to reach compliance without adequate supplier engagement.
» Communicate your expectations—for both sourcing and cooperation in the process.

Use technology to support the process

» Leverage and incorporate existing internal technologies for all aspects of your program implementation, not just survey management. Governance, risk. and compliance (GRC), workflow, and supply chain management (SCM) tools help facilitate product analysis, risk mitigation, and supplier management—all critical aspects of conflict minerals due diligence.

Engage your auditor early

» Select your CMR auditor early and engage them in the evaluation of your processes while they are still being developed.

Leverage internal audit

» The internal audit function has broad visibility into existing risk tolerance and control plans across the organization. Seek their counsel when developing the due diligence approach to help identify process risk, standardize key responses, and implement business controls.

Document as you go

» Document your key decisions, processes, and outcomes, beginning from the start of your compliance program. This includes not only supplier surveys, but also decisions like product/supplier scope, and other key judgment calls around interpreting the rule.

Monitor the issue

» Existing conflict minerals guidance is evolving due to legal challenges and scoping interpretations. Stay current to ensure due diligence activities are correctly focused on in-scope products. Leverage industry associations and external advisors for assistance in validating items in the 'grey space.'

Use risk assessment to channel your resources and create a multi-year plan

» Prioritizing your supplier base initially allows you to understand which suppliers are most important to your compliance efforts. Many other risk factors such as supplier performance metrics and 'red flags' help you assess the quality of supplier responses and align resources to manage critical relationships. Use risk assessment as a continuous process that evolves over time—it is not a discrete activity.

Establish sponsorship and supporting team

» Build the team—involve legal/compliance, sustainability, internal audit, finance, IT, supply chain, and engineering. Be clear on who is accountable (start with identifying who will be signing the Form SD) and identify day-to-day project managers.

Start at the end

» Envision—even draft a preliminary version of—your first Form SD/CMR. This will help you formulate your comprehensive data collection plan, data management strategy, internal validation process, and stakeholder communications.

A slow start may leave you behind

Preparation activities to-date vary by company and sector. Some companies are still in the early stages and have not taken action beyond general research, while other companies have already completed pilot programs of their supply chain due diligence.

Regardless of where a company is in the process, it is clear the activities required to achieve compliance take time. There are multiple aspects of a successful conflict minerals program, as outlined above. For companies that have not initiated action, focusing on these five items is the best way to get started.

» Build the team
» Create a plan in which people are accountable
» Identify applicable products and suppliers
» Consider drafting a Form SD/CMR to understand your end goal
» Document decisions as the company moves through the required steps

It's impossible to gauge the scope, time, and cost of the activities until you get started. Delaying compliance preparations may leave companies without adequate time to meet the May 2014 deadline. Companies should begin now, taking a proactive, practical approach to move their compliance efforts forward.

Bobby is a partner with PwC's Risk Assurance and Sustainable Business Solutions practice, and leads PwC's conflict minerals team. She has over 30 years of experience including auditing, risk and compliance management, privacy and sustainability engagements, as well as helping clients to develop and operate their ethical sourcing and sustainable supply chain risk management programs.

For more on PwC's conflict minerals practice, including an upcoming survey of how-companies are preparing for compliance, visit www.pwc.com/us/conflictminerals.

The questions become the opportunities

When it comes to conflict minerals, knowing where to start the conversation is vital. We can help address the complex issues and turn compliance into a competitive advantage. There is a process to everything we do and it starts with listening and identifying the right questions. Knowing where to start and what to ask comes from experience and discipline of thought. This is just the beginning of what we provide to our clients.

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Some Had Head Start on Conflict Minerals Rules

By Joe Mont

The Dodd-Frank Act has often been referred to as Wall Street reform, but the law includes several provisions that affect companies in many industries. The "conflict minerals" rule is among the most onerous of those not germane to the financial services sector.

Companies from golf club manufacturers to circuit board makers must now comply with the rule and prepare for reporting requirements that begin next year, and many of them say it comes with a huge compliance burden. Some companies, however, have been working on the conflict minerals problem for years, spurred by activists who have pushed for more transparency in the area long before the Dodd-Frank Act required it. How some of the world's largest companies are already working to comply with these new obligations may provide a game plan for their peers of all sizes.

The new rules, finalized by the Securities and Exchange Commission last August, require companies to disclose information each calendar year on the source of "conflict minerals"—including tantalum, tin, gold, and tungsten—found in their products, using a newly created Form SD. Congress included the provision in the Dodd-Frank Act to address concerns over the role of these minerals in funding armed militias in the Congo and adjoining countries.

Companies must conduct a "reasonable" country of origin inquiry to determine if the minerals came from the covered countries; track and document the source and chain of custody; and include findings in a conflict minerals report that is independently audited and posted online for at least one year.

After a long battle by many industries to push for a less onerous version of the conflict minerals rules, however, many companies now appear to be shifting to planning for compliance with it.

Follow the Leaders

They may find some comfort in the example of companies that have been working on conflict mineral-free manufacturing processes for the last few years, to avoid the ire of activists. Each year, for example, the Enough Project of the Center for American Progress issues a report that assesses how well consumer electronics companies have progressed toward conflict-free supply chains. This year's report found that four leading electronics companies—Intel, HP, Motorola Solutions, and Apple—have established conflict minerals programs that "pave the way for the rest of the industry."

Chipmaker AMD—also on the Enough Project's list—has been working on conflict minerals since well before the final rules were adopted. While Tim Mohin, director of corporate responsibility, sees ranking as validation of his company's efforts, he still thinks AMD can do better. The key to its initial success, he says, was perseverance.

"When the regulation was passed, we were in the same boat that a lot of other folks are now, which is throwing up our hands and saying, 'This is impossible, it can't be done,'" he says. "There was such fear and loathing over the rule. We had to zoom out of that, look at what this rule is about and what we are trying to accomplish here."

It also helped that the company wasn't starting from zero. Mohin says his industry first encountered the issue long before the law was passed. Electronics makers have been targeted as users of tantalum for over a decade, frequently through celebrity-fronted campaigns calling attention to its role supporting violence in the Congo. That longstanding awareness allowed many of these companies to be proactive ahead of the rule's passage or, at the very least, prepared for its inevitability.

Reaching Out to Suppliers

Mohin says the biggest challenge "was to work with suppliers and get them to understand what we were asking for and why we were asking for it. The only way this law works is if you have your full supply base completely aware and cooperating."

Jonathan Hughes, director of Assent Compliance, a consultant with a conflict minerals practice, says suppliers and vendors should reach out to the companies they do business with as soon as possible, since they may find much-needed assistance on conflict minerals compliance. "They aren't necessarily going to conduct any of the steps for you," he says. "They aren't going to do your country of origin inquiry or due diligence, but they will help put you on the right path."

AMD has been able to track the materials it uses back to about 100 individual smelters that can be analyzed to ensure that they are not sourcing materials from the conflict-ridden zone in Central Africa. Thus far, AMD has been able to certify 13 of those smelters as compliant. "The crown jewel of our entire compliance strategy is the conflict-free smelter program," Mohin says. "Without that program we don't have a system at all."

AMD relied heavily on its internal audit function to get the certification process started. "We were able to take a core competence in our industry, which was auditing, and apply that to a very different problem set, the smelter issue," he says. "Once we identified the smelters as that choke point and we developed a protocol and process, we certified auditors and we went to these places to build relationships. Now we have a growing list of smelters who aren't supporting the conflict."

Tracing minerals to the smelter, rather than the mine itself, still conforms to standards set by the Organization for Economic Co-operation and Development. The final SEC rules mandate that conflict minerals supply chain due

diligence be performed in accordance with "a nationally or internationally recognized due diligence framework." For now, the OECD guidance, adopted by 41 countries, is the only established framework available.

The effort to avoid conflict minerals is also not a new concept to Motorola Solutions. It launched its Solutions for Hope Project last July, an initiative to source conflict-free tantalum, a mineral used in capacitors for electronic products. Its partner in the effort is AVX Corp., a leading tantalum capacitor manufacturer.

At the time, the company was concerned that efforts to secure conflict-free supply chains would lead to a *de facto* embargo of minerals from the region, actually hurting those whose livelihoods depend on artisanal mining. "Taking away their economic stability will only exacerbate the problem and not solve it," says Michael Loch, director of supply chain sustainability at Motorola Solutions.

In response, Solutions for Hope developed its own network of vetted suppliers. It supports, and is supported, by other initiatives such as the conflict-free smelter program by the Global e-Sustainability Initiative (GeSI) and efforts of the Electronics Industry Citizenship Coalition (EICC).

"Part of Solutions for Hope was to get material flowing through the 'closed pipe' system so that the verification and traceability programs could be evaluated, utilized, and tested," Loch says. "Once the independent auditor verified the systems were in place and we visited the mine site, trade route, and export depot, the shipments began."

Industry Groups Step Up

Companies are also increasingly relying on industry groups and trade associations to help then navigate the rules and share data. "The scope of some of the work that needs to be done is really beyond an individual company's capabilities and that's why working together is so important," says Fern Abrams, director of government relations and environmental policy for IPC-Association Connecting Electronics Industries, the association for printed circuit board and electronics manufacturing service companies.

"Although this is not an environmental issue, many companies have assigned leadership on this issue to their environmental department," she adds. This makes sense because they have systems in place to satisfy other regulations that ban the use of certain hazardous materials and track, for example, lead content. These protocols can be adapted to conflict minerals.

Tanya Bolden, manager of corporate responsibility for the Automotive Industry Action Group, says her group has worked closely with the electronics industry, in particular the Electronic Industry Citizenship Coalition, which has developed a conflict-free smelter list and drafted industry protocols for tantalum, tin, tungsten, and gold.

In September, AIAG and iPoint, a provider of environmental compliance products, announced that a working group with representatives from two dozen member companies—including automotive industry OEMs and suppliers like Chrysler Group, Ford, and Honda—collaborated on the development of a Web-based data management tool that will help supply chain participants identify whether their products contain conflict minerals.

"Tools that benefit the automotive supply chain can also benefit other industries," Bolden says, explaining the need for scalable systems that can go from data collection to reporting to auditing. ■

PUTTING THE LEGAL TEAM ON ALERT

A drawback of the new rule is that activist shareholders and others will be watching closely. If compliance efforts don't meet their ideal, they may sue.

"Those shareholders who are very aggressive in this kind of issue are going to be looking at your competitors to see what they reported," says Jane Luxton, a partner at law firm Pepper Hamilton. "You not only have to do your own best job, you have to imagine how your competitors will be reporting because you will be looked at side by side."

Companies will also have to work to ensure that their suppliers are in compliance with the rules. "Some corporations require their suppliers to show proof that they've done audits and due diligence," says Robert Weiner, managing director and regional counsel for IPSA International, an investigative consulting and risk advisory firm. "They may represent that they conducted due diligence, but what did they really do? To what extent can you reasonably rely on the information that you are being provided? You are going to start seeing watchdog groups and activist shareholders and others saying, 'Well, that wasn't good enough, you have to do more.'"

Still, if activists shareholders bring lawsuits on the issue, they might have trouble getting support from a larger class action. Amy Goodman, a partner with the law firm Gibson, Dunn & Crutcher, in a recent webcast sponsored by the firm, said shareholder suits are generally brought when people expect large recoveries and "it is hard to imagine that would happen in this case."

Nevertheless, "we may very well be surprised by some of the reputational damage that comes from some of these disclosures," she says, adding that companies should be prepared for whistleblowers to report them if they are non-compliant.

—Joe Mont

Don't Play the Waiting Game on Conflict Minerals

By Joe Mont

When talk turns to ramping up compliance with new disclosure requirements for the use of conflict minerals in the company supply chain, Barbara Kipp, a partner in PwC's risk assurance services practice, has just one thing to say: "It's game time."

Last August, the Securities and Exchange Commission issued a final rule outlining how companies must report the use of certain minerals—including tin, tantalum, tungsten, and gold—mined in the war-torn Congo region of Africa and often used to fund violent militia groups.

The rule, a mandate of the Dodd-Frank Act, requires companies to determine and disclose the source country of the four minerals used. A Reasonable County of Origin Inquiry (RCOI) is required to determine whether they were sourced from the Democratic Republic of Congo or an adjoining country. Disclosure of this assessment is required in the SEC's new Form SD. If designated minerals do, or might, come from covered countries, additional due diligence into the source and chain of custody of those minerals is required, along with an audit of that assessment.

As months have passed, businesses digging deep into their supply chains are now beginning to assess how difficult meeting those requirements will be. While many companies continue to bemoan what they consider to be vague language in the regulations and the high cost of compliance, strategies are emerging on how to deal with the most onerous aspects.

Lagging Behind

PwC is currently surveying hundreds of companies on how they are approaching compliance with the new rule. Although responses are still being collected, initial results indicate that many companies have intentionally delayed compliance efforts. Kipp is concerned that many companies are getting too late a start to adequately meet the May 2014 deadline to file the first Form SD.

Others share those concerns. "There is very little time, only a few months, to survey your company, assess your products, be in contact with all of your suppliers and give them time to follow up with their suppliers," says Dynda Thomas, a partner with the law firm Squire Sanders. "The cascading effect of this rule means there are many steps."

"A company simply giving its suppliers a questionnaire isn't the end of the topic," she says. "Depending on the complexity of the part or product involved, there may be 10 steps down to where you finally get to the actual source of the conflict mineral."

According to the preliminary results of the PwC survey, nearly 33 percent of respondents said they are working on identifying products that may contain conflict minerals. Five percent have gathered most of the necessary data from suppliers and are assessing it as part of their RCOI obligation; only 2 percent have completed initial RCOI and started due diligence.

Some companies are playing the waiting game. Nearly 17 percent said they haven't done much or are waiting to see what happens with a legal challenge currently making its way through the courts. Last October the National Association of Manufacturers and the U.S. Chamber of Commerce filed a legal challenge to the regulation in the U.S. Court of Appeals for the District of Columbia. They are seeking that the rule be modified or set aside, due to what they see as unreasonable burden and insufficient cost-benefit analysis by the SEC (see more on that on page 16). Briefs have been filed, with oral arguments scheduled for May 15. A judge's decision isn't expected until the third quarter of the year.

Waiting until the legal challenge is resolved to begin compliance efforts is a huge gamble and an unwise approach, says Kipp. It's unreasonable to tell regulators you waited until November or December to start compliance efforts with hope the law would get repealed, she says.

"You have to get started," Kipp advises. "You need to put a team together and think about what your end game is. You need to start somewhere."

Suppliers and Demands

A significant hurdle for companies is getting their potentially vast network of suppliers to cooperate. "A lot of entities in the supply chain aren't necessarily public companies, located in the United States, or even have much visibility into this issue," says David Lynn, a partner with the law firm Morrison & Foerster. "So when they get these questionnaires from companies they are not inclined to always respond."

Another problem is that since most contracts with suppliers were drafted long before the new disclosure requirements were anticipated, companies don't have a lot of leverage to compel their suppliers to provide information, says Lynn. "They don't really have a very good hook over their suppliers," he says.

The final SEC conflict minerals rule states that to be in compliance, issuers must seek and obtain "reasonably reliable representations" from their suppliers regarding origin of the materials in question. Certainty is not required, but reasonableness is, although the definition of reason-

able is left to discretion, says Kirsten Wallerstedt, senior regulatory analyst for 3E Co., a business consulting firm.

Even companies that have been diligently collecting information from suppliers are having a lot of trouble managing the volume of data, she says.

The SEC also expects companies to be aware of, and address, "red flags" that might signify a supplier is misrepresenting information. The intent is that companies must be on the lookout for inconsistencies, and perhaps even outright lies, offered by suppliers. They cannot just take supplier questionnaires at face value, Kipp says.

Contract to Manufacture

There also remains confusion about exactly what companies the regulations cover. Those that contract out the manufacturing process must comply, for example, but those with branded or private label products are having a difficult time determining whether they meet the definition of "contract to manufacturer." The rule says that companies that have influence over the manufacturing process, as opposed to re-sellers or retailers, must file Form SD, although no clear-cut definitions were included in the regulation.

"Many companies have found this definition murky, and determining whether they meet this tipping point can be a difficult decision," Wallerstedt says. "There could be ramifications for making an incorrect determination."

The expectation is that the SEC probably won't provide much public clarification on who is subject to the contract manufacturer rule, but will likely do so through a number of private letter rulings, as has been their approach in the past, she says, explaining that some of her clients have started collecting conflict minerals information for their private labels as a precaution.

Thomas says companies that engage in businesses deemed "maintenance and repair" might also need to worry about the rule, especially if they replace returned products with new ones. "Under those circumstances they could very easily be found to be a manufacturer, because they are introducing a product into the stream of commerce," she says.

The Problem With Packaging

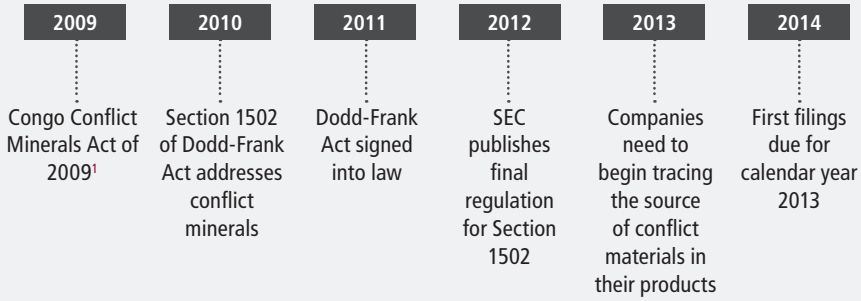
Thomas says product packaging must also be carefully considered. A footnote in an SEC brief filed for the lawsuit indicates that it never intended packaging to be covered by the rule. Although some are interpreting this as a break for companies, she warns that this likely only applies to boxes used to ship a product not, for example, the outer layer of a cell phone that wraps up the inner workings as some are arguing.

Conflict minerals rule compliance could be further complicated by new rules from other countries. Canada and the European Union, for example, are considering new conflict mineral requirements of their own, and they could be broader than the ones the United States has adopted. "What's troubling to me is [the proposed Canadian rule] is inconsistent with the U.S. rule," Thomas says. "Having inconsistent, yet overlapping rules, would create a lot of extra work for companies." ■

DODD-FRANK 1502 COMPLIANCE TIMELINE

When does compliance begin?

First filings are due May 31, 2014, for calendar year 2013



[1] Legislation did not pass committee and was added to the Dodd-Frank Wall Street and Consumer Protection Act

Source: PwC.

SEC's Conflict Minerals Rule Lacks Clarity

By Joe Mont

Outside legal counsel will likely never put it so bluntly, but whenever a new regulation emerges one of their tasks is to determine how much wiggle room a company can count on.

Analysis of recent Securities and Exchange Commission rulemaking on the tracking and disclosure of the use of so-called "conflict minerals" in the supply chain, however, has been less about looking for loopholes and more about trying to decipher its many ambiguities and gray areas that are open to interpretation.

The rule, finalized by the SEC in August, requires companies to disclose information each calendar year on the source of "conflict minerals"—tantalum, tin, gold, and tungsten—in their products, using the new, electronically filed Form SD. Congress included the provision in the Dodd-Frank Act to address concerns over the role of these minerals in funding armed militias in the Democratic Republic of the Congo and adjoining countries.

Companies must conduct a "reasonable" country-of-origin inquiry to determine if the minerals originated from the covered countries; track and document the source and chain of custody; and include findings in a public Conflict Minerals Report.

Exactly what the standard is for a "reasonable" inquiry is just one of the many gray areas companies are finding as they dig through the more than 300-page rule. The rule doesn't provide overly specific guidance, giving issuers flexibility to tailor those tasks to their specific circumstances. The ambiguities, however, create tension, as companies worry about doing enough to comply with the regulation, without incurring unnecessary compliance costs.

Curtis Dombek, a partner with the law firm Sheppard Mullin, says the many questions that arise shouldn't come as a surprise. "The conflict minerals area is full of terms that are susceptible to a wide interpretation. If you want to go through the rule and look for important terms that are left undefined and potentially vague, you will find them," he says.

Several questions are still unanswered by the final version of the conflict minerals rule. Below are some of the major open issues.

What exactly does 'contract to manufacture' cover?

Companies that "contract to manufacture" a product from a supplier are subject to the conflict minerals rule, but the term isn't defined. The intricacies of "contract to manufacture" is "one of the biggest mysteries in this rule, with a lot of room for interpretation," says Jane Luxton, a partner at law firm Pepper Hamilton.

It is among the terms the SEC uses to explain what products companies must evaluate for conflict minerals. Whether an issuer will be considered to "contract to manufacture" a product or simply to purchase it for resale depends on the degree of influence it exercises over the materials, parts, ingredients, or components that contain conflict minerals.

But even the SEC itself, in the final rule, says it does "not define the phrases 'contract to manufacture,' 'necessary to the functionality' of a product, and 'necessary to the production' of a product." Instead it offers "additional guidance for issuers to consider regarding whether those phrases apply to them."

Luxton finds much of that guidance lacking. For instance, she says an SEC example of when a retailer wouldn't be subject to the rules isn't very helpful. In that example, a retailer that only has a manufacturer put its label on a device wouldn't be considered contracting to manufacture.

"The SEC adopting release to the rule carves out several circumstances from the scope of the rule but otherwise provides little guidance as to how much influence over the product's manufacturing is required," says Amy Goodman a partner with the law firm Gibson, Dunn & Crutcher.

For example, the SEC has expressed the view that if a company specifies to the manufacturer of a product that a conflict mineral is to be included in the product, the company will be subject to the rule.

Another challenging interpretive issue under the rule is the question of what is a "product." "Is something a 'product' only if the company sells it, or does the conflict minerals rule extend beyond that, for instance to giveaways and promotional items?" Goodman asks.

As companies sort out their obligations rule, they are likely to face a number of lingering questions, including the issue of what it means for conflict minerals to be "necessary to the functionality" of a product, she adds. "Is the tin coating, used to prevent corrosion, on a can of hairspray or shaving cream necessary to the functionality of the product?"

How should a company root out its supply chain?

The SEC rulemaking is more explicit about the resulting information it is looking for than the process that companies use to determine it. Instead, it hands over that responsibility to "a nationally or internationally recognized due diligence framework." For now, a guidance framework established by the Organization for Economic Co-operation and Development is the only one available.

As for programs in place up the supply chain that provide chain of custody information back to the original source, a number of efforts are underway.

"But the only one that really has been approved is the one

for gold—the gold supplement to the OECD framework," says Luxton. "The others are in progress and encountering a fair amount of difficulty tracing a lot of the minerals, especially in the earliest stages between the smelter, which is a natural chokepoint, back to the mine." A big reason, she says, is that many of these minerals are mined by artisanal, individual miners working with numerous intermediaries and middlemen.

Could a company be liable for criminal penalties?

Blake Coppotelli, a managing director with Freeh Group International Solutions, says criminal exposure is a very real possibility. The federal false statements statute, which prohibits concealment of material fact in a government form, could apply to Form SD.

"If there was more than one person involved in concealing material facts or making a false statement, you could also be liable for a conspiracy charge," he says. "As with any criminal law issues on how a prosecutor would view something is very unpredictable."

Another hazard is inherent in the relationship between conflict minerals and human rights abuses and armed renegade groups. "If there was evidence of what government perceives as a false statement resulting in especially egregious facilitation of one of these armed groups, or an especially large amount of funds going to one of them, you could see a prosecutor [pursuing] a company," Coppotelli says. "The risks are uncertain in this area, but the stronger the compliance system the less likely the company is to face that risk."

What happens if a company fails to file, or provides an incomplete form SD?

Robert Friedel, a partner with the law firm Pepper Hamilton, who specializes in securities law compliance, says that Form SD requirements, if not fully met, might not just incur direct sanctions by the SEC. They could affect company stock offerings, sales, and repurchases.

Affiliates of companies looking to sell stock are subject to various limitations, and making sure the company is current in all its SEC filings is among them, Friedel says. If the company hasn't filed Form SD, these insiders will not be able to sell securities on the public market. Companies looking to do a registered public offering will also face an SEC review to ensure they are current in all their filings.

Neglecting Form SD could also restrict companies from taking advantage of favorable regulations. Companies that are eligible to file a Form S-3, a simplified registration form, for example, could lose that opportunity if they fail to file Form SD, or are late doing so. That negligence could mean they couldn't take advantage of the filing until June 1 of the following year once they do file.

Can companies amend Form SD?

As a new requirement, companies may find they need to file an amendment to Form SD. The problem, Friedel says, is that there is not yet a means to do so with the electronic filing.

He expects disclosure standards will evolve over time as companies settle on an approach.

"Do they want to be on the leading edge of providing the most robust and full disclosure, or do they just want to do what's sufficient," he says. "That's a perfectly fine choice to make and there is no obligation to be at the head of the class."

If competitive pressures and a push from activists lead to a need for updating filings, however, some creativity is needed to make it happen. "Until the SEC creates a special document amendment code, companies that need to file an amendment should file under the SD code and simply call it, on the cover page, amendment number 1, 2, et cetera," Friedel says.

With the first wave of conflict minerals reports due in May of 2014, companies and the SEC have some time to sort through the uncertainties, but not a lot. Without further guidance issuers will be forced to make some judgments. Says Goodman: "We may get more guidance from the SEC on these sorts of issues, but especially in areas of uncertainty, it is important that companies carefully document their determinations." ■

FCPA PROBE RESOLUTION

The following is from a fact sheet on the conflict minerals rule published by the Securities and Exchange Commission in August.

Contracting to Manufacture:

A company is considered to be "contracting to manufacture" a product if it has some actual influence over the manufacturing of that product. This determination is based on facts and circumstances, taking into account the degree of influence a company exercises over the product's manufacturing.

A company is not be deemed to have influence over the manufacturing if it merely:

- Affixes its brand, marks, logo, or label to a generic product manufactured by a third party.
- Services, maintains, or repairs a product manufactured by a third party.
- Specifies or negotiates contractual terms with a manufacturer that do not directly relate to the manufacturing of the product.

The requirements apply equally to domestic and foreign issuers.

Source: SEC.

How H-P Is Tackling Conflict Minerals Compliance

By Joe Mont

While some companies are struggling to get compliance with the Securities and Exchange Commission's Conflict Minerals Rule on track to meet the May 2014 deadline, others have been working on the problem for years and are way ahead of the curve.

Hewlett-Packard, for example, began work on tracing conflict minerals in the supply chain and disclosing the results in 2007, long before the SEC adopted a rule last August mandating new disclosures on the use of minerals mined in Africa. Despite progress and its role as an industry leader, Jay Celorie, who manages H-P's conflict minerals program as global program manager, says its work is still in the early and evolving stages. Those words won't come as a relief to companies just getting started on compliance with the rule.

The Conflict Minerals Rule, mandated by the Dodd-Frank Act, applies to the mining of tin, tungsten, tantalum, and gold in war-torn Central Africa, where the proceeds of such mining funds brutal militant groups. The rule requires companies to determine and disclose the source conflict minerals. If designated minerals do, or might, come from covered countries, additional due diligence into the source and chain of custody of those minerals is required, along with an audit of that assessment.

The value of the Congo's mineral wealth is estimated as high as $24 trillion and the SEC rule is estimated to directly apply to nearly 6,000 companies and hundreds of thousands of their suppliers. Critics have lamented that purging their supply chains of these substances, or even just tracking their origin, is a costly challenge, and business groups, including the U.S. Chamber of Commerce, have challenged the ruling in court.

While that challenge winds its way through the legal system, many companies are finding compliance with the rule to be tricky. "One of the challenges with this topic is that it is highly nuanced," says Celorie. "It may seem reasonable on the surface, but it is really not that simple."

H-P's early response to the issue came as non-governmental organizations and advocacy groups began to pressure the industries that rely on them to do a better job of tracking their use of the metals and sourcing them from other regions. It was at that time that H-P became an active participant in the Electronic Industry Citizen Coalition and Global e-Sustainability Initiative (GeSI), and formed its own extractives workgroup to compliment those initiatives.

The key question H-P faced, Celorie says: "How do we develop programs tools and methods to enable us to source responsibly?" The scope of such an effort was daunting. H-P has one of the industry's most extensive supply chains, comprising more than 1,000 production suppliers and tens of thousands of non-production suppliers, spanning more than 45 countries and territories. "The challenge is that these smelting facilities are fairly deep inside of our supply chains," Celorie adds. "So it's not that we have lines of sight or direct influence over these facilities."

Conflict-Free Smelters

H-P started its review at the mine level, seeking to understand the chain of custody from the mining facilities to the smelters. Next, it developed a Conflict-Free Smelter (CFS) program, with an audit protocol that NGOs and stakeholders could agree to when evaluating claims that a smelter is sourcing conflict-free materials. A common data format was developed for exchanging information on what smelters are in H-P's supply chain.

Those steps have been a multi-year effort, Celorie says. Although much more work remains, the plan is coming to fruition. In April, H-P published a list of the 195 smelters that have been identified as in use within its supply chain. While the smelters have not been certified as free of the use of conflict minerals, identifying the smelters in the supply chain is an important first step. In doing so, it is the first IT company to publish its supply chain smelter list and to obtain an independent review of the smelter identification process.

Advocacy groups that track the use of conflict minerals have applauded the move. "Publishing its list of smelters is another significant step in the right direction, because it puts pressure on smelters to be audited as conflict free," says Sasha Lezhnev, senior policy analyst, the Enough Project. "Just a year ago, companies were afraid of publishing lists of smelters, but this added layer of transparency can help get our consumer products to be conflict free."

The next step is to certify as many of the smelters in use as free of conflict minerals. "We have 29 smelters on the CMS list and we really need to grow that to a larger number," Celorie says. "We cannot do it alone and we need to work as an industry, and with other industries. It takes a while for others to get involved, understand what needs to be done, and what their role could be."

Despite the SEC's new requirements and approaching deadlines, many companies, including those in the electronics industry, have indeed moved slowly on Conflict Minerals Rule compliance. In fact, more than one-third of electronics firms indicating they haven't even commenced compliance planning, according to a new survey from information and analytics provider IHS. Compa-

nies are "woefully unprepared for the new regulations," it concluded.

The poll, conducted in April with 134 electronics industry managers, found that more than 35 percent have made no plans on how to conform to the rules; just 7.5 percent said that they were "well-prepared" for compliance.

Wielding Influence

Celorie says of industry efforts, "It's going to take time. The key is really growing a larger number of smelters that are choosing to become CFS compliant and then driving our suppliers to using those smelters."

His advice for those who have lagged in their efforts is to partner with efforts like the Extractives Workgroup (which charges a $5,000 membership fee), and take advantage of the many consultants and seminars, many of which are available for free advice.

H-P takes a supplier-level approach to conflict minerals. Companies like AMD and Intel have been supportive partners, but not all suppliers have the willingness, or capability to trace the materials they use. The company takes different strategies when wielding its influence. For smaller organizations, from which it doesn't purchase as much, the focus is on education. "You need to train on what you are asking of them, and you need to allow them the time to come up to speed and respond," Celorie says.

With larger suppliers, there is more of a strategic relationship. "We are buying a higher volume of material, and we have much more influence," he says. "They are more sophisticated and can afford to devote more resources. We are asking them to propagate what we are asking of them throughout their supply chain, and we are seeing some success."

H-P is also a supporter of a "closed-pipe" approach to sourcing, as championed by Motorola's Solutions for Hope project and the Conflict Free Tin Initiative. These efforts seek to limit the number of participants between the smelter and mine and control leakage. Mining companies are encouraged to invest in local development, such as health clinics and clean drinking water.

"These closed pipes aren't easy things to do," Celorie says. "They are very challenging. You need adequate infrastructure and roads to get to an export point. Then, you need a mining company that is willing to pay for the minerals, at the mine, on a daily basis and then transport and package them and sell them to a conflict-free smelter. It takes a lot to make them work, which is why we only have a few examples."

Celorie recalls a recent trip to the Congo that re-energized him to do what he can to solve the conflict-minerals problem. "As our helicopter landed, we had about 400 women and children come out to greet us, waving and smiling," he says. "They know that we and other companies are trying to make a difference in their lives." ■

CONFLICT-FREE SMELTER PROGRAM

The following is an overview of Conflict-Free Smelter Programs published by the Electronics Industry Citizenship Coalition (EICC).

The EICC and Global e-Sustainability Initiative (GeSI) are taking action to address responsible material sourcing through the development of the Conflict-Free Smelter (CFS) program. The CFS is a voluntary program in which an independent third party evaluates a smelter's procurement activities and determines if the smelter demonstrated that all the materials they processed originated from conflict-free sources.

The CFS assessments cover smelters processing tin, tungsten, tantalum, and refiners processing gold (called smelters here forward). The assessments are conducted globally for any smelter who is processing the targeted minerals and wants to be identified as a conflict-free smelter.

CFS Process

The CFS Program consists of two reviews that occur at a smelter's site: a Business Process Review and A Material Analysis Review.

If, during the assessment, the smelter is able to demonstrate that they have sourced conflict-free, based on the sourcing location requirements of the CFS program, the third party assessment firm will recommend to the CFS Assessment Review Committee that the smelter be identified as being compliant. The CFS Committee reviews the assessment report, and if they agree that the assessor's conclusions, they will recognize the smelter as being CFS-compliant. If, during the assessment, the third-party assessment firm finds non-compliances to the CFS protocol, the smelter will have three months to resolve the issues and undergo a reassessment.

CFS-Compliant Smelters

The EICC and GeSI publish lists of smelters, by metal, found to be compliant with the CFS protocol; the lists will be updated quarterly, or more frequently if appropriate. The EICC and GeSI will not publish information on smelters who are either not compliant with the CFS protocol or have not gone through a CFS assessment. Inquiries as to a smelter's CFS status should be made directly with the smelter in question. Registration is required to access the CFS smelter list.

Determination of whether and/or how to use all or any portion of the list is to be made in a company's sole and absolute discretion. Use of the list is voluntary.

Source: Electronics Industry Citizenship Coalition.