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SEC Proposes Rules to Implement Dodd-Frank Requirements for Conflict Minerals Originating in the Democratic Republic of Congo

The SEC has proposed rules that implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Act which requires companies that file Exchange Act reports, whether U.S. companies or foreign private issuers, to provide disclosures about conflict minerals that are "necessary to the functionality or production of a product manufactured by the company." This disclosure requirement is expected to impact companies in a wide variety of industries due to the broad use of the minerals classified as "conflict minerals" under the provisions. The proposed rules are also fairly broad in their definition of "manufacture" and could therefore impact companies that do not manufacture their own products. The proposals are subject to a comment period ending January 31, 2011.

See Annex A of this memorandum for a quick reference chart illustrating the proposed rules requiring the disclosure of conflict minerals.

What are "Conflict Minerals"?

The Dodd-Frank Act and the SEC's proposed rules define conflict minerals as: cassiterite, columbite-tantalite, gold, wolframite, or their derivatives, or any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of Congo or an adjoining country (called "DRC countries"). As mentioned above, these minerals have a wide range of uses and the proposed rules would therefore apply to companies in a variety of industries. For example, the release notes that:

- *Cassiterite* is the metal ore that is most commonly used to produce tin, which is used in alloys, tin plating, and solders for joining pipes and electronic circuits.
- *Columbite-tantalite* is the metal ore from which tantalum is extracted.
- *Tantalum* is used in electronic components, including mobile telephones, computers, videogame consoles, and digital cameras, and as an alloy for making carbide tools and jet engine components.
- *Gold* is used for making jewelry and is also used in electronic, communications, and aerospace equipment.
- *Wolframite* is the metal ore that is used to produce tungsten, which is used for metal wires, electrodes, and contacts in lighting, electronic, electrical, heating, and welding applications.

When and What Disclosure of Conflict Minerals Would Be Required?

The proposed rules would require companies that file Exchange Act reports with the SEC to undertake a three-step analysis, as illustrated by the chart in Annex A, to determine whether disclosure is required and, if so, what they are required to disclose about their use of conflict minerals. The threshold inquiry would be:

Step 1: Are conflict minerals necessary to the functionality or production of a product manufactured or contracted to be manufactured by the company?

Companies that do not meet this criteria would not be subject to the rules. Companies that do meet this criteria would be required to move on to Step 2 of the analysis which would require the company to inquire into the country of origin of the conflict minerals and make certain disclosures about the conflict minerals.

When are conflict minerals "necessary to the functionality or production" of a product?

Although not expressly defined in the proposed rules, the proposing release indicates that conflict minerals would be considered "necessary to the functionality or production of a product" if intentionally included in a product's production process and necessary to that process, even if the conflict mineral is ultimately not included in the final product. On the other hand, conflict minerals necessary for the functionality or production of a physical tool or machine used to produce a product would not be considered necessary to the functionality or production of the product, even if that tool or machine is necessary to producing the product. By way of example, the release indicates that a wrench containing conflict minerals that is used to produce an automobile would not be considered "necessary" for production of the automobile.

What does it mean "manufacture" and "contract to manufacture" for purposes of the proposed rules?

The proposed rules do not define what it means to "manufacture" or "contract to manufacture" a product containing conflict minerals but the SEC indicates in the release that this would encompass companies that:

- have influence over the manufacturing of products containing conflict minerals;
- sell generic products containing conflict minerals under their own brand name or a separate brand name that they have established. These companies would be considered to "manufacture" or "contract to manufacture" conflict minerals regardless of whether they have any influence over the manufacturing specifications of the product, as long as the company has contracted with another party to have the product manufactured specifically for that issuer; or
- mine or contract to mine conflict minerals, including companies that mine or contract to mine gold.

Retail issuers that (1) sell only products of third parties if those retailers have no contract or other involvement regarding the manufacturing of those products or (2) do not sell those products under their brand name or a separate brand they have established and do not have those products manufactured specifically by them, would not be deemed to "manufacture" or "contract to manufacture" these products. However, since many retailers manufacture and sell their own products, this could have a significant impact on them.

Step 2: Make a Reasonable Inquiry into Whether Necessary Conflict Minerals Originated in DRC Countries

If a company determines that conflict minerals are necessary to the functionality or production of a product manufactured or contracted to be manufactured by the company, it would then be required to make a reasonable inquiry into the country of origin of the conflict minerals. The proposed rules do not define the steps necessary to constitute a reasonable inquiry although the release does say that a company might be able to satisfy this standard by receiving reasonably reliable representations and/or certifications about the origin of the conflict minerals from the facility at which the conflict minerals were processed. While companies would not be required to determine the country of origin with absolute certainty at this stage in the analysis, they would be incentivized to undertake a fairly thorough examination of the country of origin in order to avoid moving forward to the next stage of the analysis, which requires additional disclosures and the provision of a conflict minerals report and applies if the company (1) cannot determine that the conflict minerals did not originate in a DRC country or (2) determines that the conflict minerals did originate in a DRC country.

Step 3: Perform Due Diligence on the Source and Chain of Custody and Furnish a Conflict Mineral Report Along with Independent Audit Report

If a company that determines that its necessary conflict minerals originated in DRC countries or it is unable to determine that its minerals did not originate in DRC countries, it would be required to (1) exercise further due diligence on the source and chain of custody of the conflict minerals and (2) provide

disclosure about this process in its annual report on Form 10-K, 20-F or 40-F and in a "conflict minerals report" that would be furnished as an exhibit to that annual report. The conflict minerals report would need to accompanied by an independent audit report and include a description of:

- the company's products that are not "DRC conflict-free";
- the facilities used to process these conflict minerals; and
- the country of origin of these conflict minerals.

The conflict minerals report and accompanying audit report would each be "furnished" rather than filed and would therefore not be subject to Section 18 liability or incorporated by reference into any other filing under the Securities Act or Exchange Act unless a company explicitly incorporated it into the filings.

Reporting Dates

Companies subject to the rules would first be required to provide conflict mineral disclosures in their annual report for their first full fiscal year following the SEC's adoption of final rules. Assuming the rules are adopted by April 2011 as required by the Dodd-Frank Act, this would mean that calendar year-end issuers subject to the rules would first provide conflict mineral disclosure in their annual report for the fiscal year ending December 31, 2012 which would necessitate the tracking of information relating to the use and origin of conflict minerals as of January 1, 2012.

The proposing release indicates that companies would provide conflict mineral disclosure for the annual period in which the company first took possession of the conflict mineral.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

Joseph A. Hall	212 450 4565	joseph.hall@davispolk.com
Michael Kaplan	212 450 4111	michael.kaplan@davispolk.com
Theodore A. Paradise	+81 3 5561 4430	theodore.paradise@davispolk.com
Richard J. Sandler	212 450 4224	richard.sandler@davispolk.com
Richard D. Truesdell, Jr.	212 450 4674	richard.truesdell@davispolk.com
Janice Brunner	212 450 4211	janice.brunner@davispolk.com

Annex A

Conflict Mineral Disclosure Analysis