May 2015

Conflict Minerals Update: Next Form SD Due June 1

June 1, 2015, is the due date for the next Form SD filing for those public companies required to report to the Securities and Exchange Commission (SEC) on the inclusion of conflict minerals in their products. This alert provides an update on developments in SEC conflict minerals reporting since June 2, 2014, the due date for the prior round of Form SD filings.

Review of 2014 Filings

More than 1,000 public companies filed Form SD in 2014. Not surprisingly, industries with high Form SD filing rates included retailers and traditional manufacturers in the automotive, aerospace, electronics, semiconductor and computer sectors. On the other hand, industries not associated with traditional manufacturing activity had low Form SD filing rates, including companies in the banking, health care, insurance, telecommunications, food/grocery, utilities and airline sectors. In light of the newness of the rule as well as the lack of precedents to follow, Form SD disclosures in 2014 did not follow any single pattern. We have observed a great deal of diversity in disclosure practice among those companies filing Form SD last year. Notably, only four companies obtained independent private sector audits and sought to claim "conflict free" status.

Status of Litigation

As we previously summarized, a group of trade associations judicially challenged the SEC's conflict minerals rule. On April 14, 2014, a panel of the Court of Appeals for the District of Columbia Circuit issued its opinion, upholding parts of the rule but also effectively striking down on First Amendment grounds that portion of the rule that required companies to describe their products as "DRC Conflict Free," "DRC conflict undeterminable" or "not found to be 'DRC Conflict Free,' " as the case may be. In a concurring opinion, however, one of the judges on the panel suggested that the court was premature in issuing its First Amendment opinion in light of a second, unrelated case raising similar First Amendment issues that was then pending before the full DC Circuit.[1]

After the DC Circuit ruled *en banc* in the second case, the court instructed the SEC and appellant trade associations in the conflict minerals case to submit supplemental briefing on the First Amendment issues in light of the intervening opinion. The SEC also filed a petition for rehearing or rehearing *en banc*. We do not expect any further activity on the case prior to the June 1 Form SD reporting deadline.

SEC Guidance

In response to the April 2014 DC Circuit opinion, the SEC staff issued a public statement (the Statement) on April 29, 2014. According to the Statement, a reporting company's Form SD, and any related Conflict Minerals Report, should comply with and address those portions of the conflict minerals rule the DC Circuit upheld. Thus, the Statement provides that companies that do not need to file a Conflict Minerals Report should disclose their reasonable country of origin inquiry and briefly describe the inquiry they undertook. For those companies that are required to file a Conflict Minerals Report, the report should

[1] *Am. Meat Inst. v. USDA*, 760 F.3d 18 (D.C. Cir. 2014).

include a description of the due diligence that the company undertook. Moreover, the Statement instructs that if a reporting company has products that fall within the scope of Items 1.01(c)(2) or 1.01(c)(2)(i) of Form SD, it would not have to identify the products as "DRC conflict undeterminable" or "not found to be 'DRC conflict free,' " but instead should disclose, for those products, the facilities used to produce the conflict minerals, the country of origin of the minerals and the efforts to determine the mine or location of origin.

The Statement further provides that no company is required to describe its products as "DRC conflict free," having "not been found to be 'DRC conflict free' " or "DRC conflict undeterminable." Nevertheless, if a company voluntarily elects to describe any of its products as "DRC conflict free" in its Conflict Minerals Report, the Statement provides that the company would be permitted to do so as long as it had obtained an independent private sector audit as required by the rule. An audit will not be required unless a company voluntarily elects to describe a product as "DRC conflict free" in its Conflict Minerals Report.

While it is clear from public statements made by SEC staff that scrutiny of Form SD has been included in the routine filing review process, it does not appear that the SEC staff has taken a great interest in commenting on Form SD filings thus far. To date, the SEC has not publicly released any comment letters to companies concerning disclosures made in Form SD. Accordingly, there is nothing to be gleaned from the SEC review process. Nor has the SEC's Division of Enforcement announced enforcement action against any public companies based on alleged noncompliance with the conflict minerals rule.

The SEC staff has been relatively tight-lipped about the rule at industry conferences, though Keith Higgins, director of the Division of Corporation Finance, did offer three general observations at a September 2014 American Bar Association meeting.

According to media reports of the event, Higgins noted that there could be overlap between the reasonable country of origin (RCOI) and due diligence processes. In that case, there is no requirement for companies to perform an RCOI if they go directly to the due diligence phase. He also cautioned that if a company determines that its conflict minerals did not originate in the conflict region, it should provide "clear and specific language" about the process used to reach that determination.

Second, Higgins observed that some companies appeared to imply in Form SD that their products are conflict-free without using that express description. Higgins warned against this technique, reiterating that companies choosing to characterize their products as DRC conflict-free must provide an independent private sector audit of their disclosures.

Finally, Higgins noted that even if a company cannot determine whether its products included minerals from the conflict region, it must still disclose the smelter or refiner used to process its minerals, if such facilities are known. He concluded that the staff is unlikely to provide additional interpretive guidance regarding the rule while the DC Circuit appeal is still pending. Accordingly, the SEC staff has not published any additional interpretive guidance on Form SD or the conflict minerals rule since it issued FAQs in March 2013 and supplementary FAQs in April 2014.

NGO Guidance

Several of the NGO groups that have supported the adoption of the conflict minerals rule have been increasingly vocal in laying out what they perceive as best practices in Form SD compliance and reporting. Two recent reports—one produced by the Responsible Sourcing Network and the other jointly authored by Amnesty International and Global Witness—outline these organizations' preferred approaches.[2]

[2] The reports are available at http://www.sourcingnetwork.org/expectations-shortlist/ and https://www.globalwitness.org/documents/17915/Digging_for_Transparency_hi_res.pdf.

Both reports encourage greater industry engagement in efforts intended to promote conflict-free sourcing, such as greater participation in conflict-free certification programs. They also encourage companies to pursue an improved response rate from suppliers by, among other things, providing training to suppliers, amending terms of supply agreements and adopting policies for dealing with uncooperative suppliers. The groups also would like to see a higher level of detail in Form SD to improve transparency into companies' diligence and reporting efforts. For example, they would like to see more discussion surrounding supplier engagement and response rates, more specific identification of smelters and refiners appearing in the supply chain, and more robust discussion of risk management and risk mitigation efforts.

We emphasize that many of the recommendations in these reports go beyond what is strictly required under the SEC rule, so from a legal compliance perspective, there is a high level of optionality for companies considering whether to follow any of this guidance.

Other Reminders

We continue to field a number of questions concerning Form SD and conflict minerals reporting. A few additional reminders include the following:

- The SEC staff has corrected a glitch in the EDGAR filing system that prohibited some companies from filing the Conflict Minerals Report as Exhibit 1.01 to Form SD. All filers should now use Exhibit 1.01 for this report when required.

- The SEC staff's prior interpretive guidance (including the Statement) remains in effect. Thus, companies are still not required to use the constitutionally infirm terminology "DRC Conflict Free," "DRC conflict undeterminable" or "not found to be 'DRC Conflict Free' " in Form SD.

- A reporting company is not required to obtain an independent private sector audit unless it claims to be DRC conflict-free. In other words, companies not claiming this status need not obtain an audit.

- In light of Director Higgins' observations, reporting companies should take care not to imply that their products are conflict-free without using that express description.

- Reporting companies and their downstream suppliers should become familiar with the SEC's guidance on the conflict minerals rules, specifically the FAQs issued in March 2013 and the supplementary FAQs issued in April 2014. Understanding what is in scope of the rule can help prioritize and streamline supply chain due diligence efforts. We have observed a significant amount of energy spent by reporting companies and their suppliers doing diligence on categories of items that are outside the scope of the reporting obligations in most instances (*e.g.*, product packaging and tools and equipment used to produce products).

- A reporting company that acquires a business that sells products containing conflict minerals will have two to three reporting cycles before it must include the acquired business' products in its Form SD if the acquired business was not previously obligated to file a Form SD. If the business is acquired *prior to* April 30, its products will not be subject to reporting until the following calendar year, and its products will first be included in the reporting company's Form SD filed in the second year after the acquisition. If the business is acquired *after* April 30, its products will not be subject to reporting until the second calendar year following the acquisition, and its products will first be included in the reporting company's Form SD filed in the *third* year after the acquisition.

- For issuers that become reporting companies through an initial public offering, the SEC has confirmed that it will apply the same timing noted above for acquisitions. The issuer must file its first Form SD for the first calendar year that begins no sooner than eight months after the date of its initial public offering registration statement.

- Given that the SEC's conflict minerals rule and interpretive guidance do not prescribe how reporting companies should describe their due diligence efforts, NGOs will continue to press for more robust disclosure. Reporting companies must balance their efforts to comply with the rule's basic requirements against the reality of the audience most likely to analyze their disclosures.

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