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Client Alert

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2016 Conflict Minerals Update

May 31, 2016, 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 1, 2015.

Status of Litigation

In response to a challenge of the SEC conflict minerals rule by a coalition of trade associations, the Court of Appeals for the District of Columbia Circuit issued an opinion in April 2014. That opinion upheld parts of the rule but also effectively struck 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. On rehearing, in August 2015 the DC Circuit reaffirmed its April 2014 decision. The DC Circuit then denied an SEC and NGO's petition for rehearing *en banc* the following November. Finally, in March 2016, Attorney General Loretta Lynch notified Congress that the federal government would not petition for a writ of certiorari to the Supreme Court. The deadline to file the petition passed in April. Thus, the appellate process has been exhausted.

The next procedural step in the case is remand back to the district court for further proceedings consistent with the DC Circuit holding. Those proceedings are likely to consider whether the First Amendment violation applies solely to the SEC rule or also Section 1502 of the Dodd-Frank Act. Depending on how the district court ultimately rules, the SEC may be required to rewrite some or all of the conflict minerals rule. Until the district court rules, however, public companies should continue to take steps to file their next Form SD by May 31.

SEC Guidance During Pendency of Judicial Challenge

In response to the initial April 2014 DC Circuit opinion, the SEC staff issued a public statement (the Statement) on April 29, 2014, which still remains in force. 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 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.

To date, the SEC staff has not publicly released any comment letters to companies concerning disclosures made in Form SD. Nevertheless, Keith Higgins, director of the SEC's Division of Corporation Finance, offered three general observations about conflict minerals reporting 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 inquiry (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 judicial challenge 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.

Filings Made in 2015

A small number of public companies have placed the Conflict Minerals Report at the center of sustainable sourcing efforts and produce a detailed disclosure document accompanied by an independent private sector audit. For many public companies, however, conflict mineral reporting continues to present various challenges. For example, last year most companies continued to report that they faced difficulties of one kind or another in their efforts to trace the country of origin of conflict minerals in their supply chains. Few sought to have their calendar year 2014 Conflict Minerals Reports audited. Coupled with the continued litigation overhang in the DC Circuit and the SEC's lack of comment on filed forms, this outcome is perhaps not surprising.

Nonetheless, many calendar year 2014 filings showed improvement over those made for calendar year 2013. Despite the many challenges, companies were able to provide more detail on smelter and refineries in their supply chains. Greater numbers of companies also disclosed information about supplier response rates and related statistics about the supply chain. Narrative descriptions concerning compliance procedures also expanded, as did the description of the OECD Guidance framework.

Reminders and Recommendations

- 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.

- RCOI and due diligence efforts should go beyond the first or second tier of suppliers to uncover the facilities used to produce the conflict minerals included in a company's products and the country of origin of the minerals.

- 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.

- Reporting companies should take care not to imply that their products are conflict-free without using that express description. Doing so, of course, triggers the audit requirement.

- Companies should continue to refine their disclosures to distinguish between their RCOI efforts and their due diligence efforts. If the audit requirement is reinstated at some point in the future, such delineation will help make the disclosure easier to review for audit compliance purposes as the scope of the audit focuses on a company's due diligence processes.

- Several socially responsible investors and NGO groups continue to express their dissatisfaction with the current state of conflict mineral reporting. Given the passage of time since the SEC first adopted its rule, reporting companies should revisit their conflict mineral compliance policies and procedures to ensure that they have kept pace with the current expectations of consumers, suppliers, commercial customers, socially responsible investors and NGOs.

- NGOs, academics and other interested groups continue to review and publish rankings on company Form SD filings according to various data points that include compliance with the SEC's rule *and* their own specific views on best practices. Companies may wish to stay abreast of where they stand in these rankings relative to peer companies.

- The European Union will continue its efforts on conflict minerals regulation, including whether to have a voluntary or mandatory supply chain due diligence system. We will continue to monitor their progress and provide updates.

- Companies should consider joining a multi-stakeholder initiative, such as the Conflict-Free Sourcing Initiative or an industry-specific group. Such a membership can pay benefits in terms of keeping abreast of evolving best practices and facilitating data collection and sharing on smelters, refiners and other sources of conflict minerals.

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