HUNTON& WILLIAMS

Client Alert

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2017 Conflict Minerals Update

With less than two months before the May 31 deadline for public companies to report to the Securities and Exchange Commission (SEC) on the inclusion of conflict minerals in their products, the United States District Court for the District of Columbia entered a final judgment in *National Association of Manufacturers v. Securities and Exchange Commission,* the litigation surrounding the SEC conflict minerals rule. This alert provides a summary of legal developments over the past year on the topic of conflict minerals, including the SEC's most recent action, and provides our suggestions for compliance for the next year.

History of Conflict Minerals Litigation

In response to a challenge to the SEC conflict minerals rule by a coalition of trade associations, the US Court of Appeals for the District of Columbia Circuit issued an opinion in April 2014 that upheld most of the conflict minerals rule, but also struck down on First Amendment grounds that portion of the conflict minerals 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 next procedural step in the case was remand back to the district court for further proceedings consistent with the DC Circuit holding.

In response to the initial 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. Companies that are required to file a Conflict Minerals Report should include a description of the due diligence that the company undertook, the facilities used to process the conflict minerals (if known) and their countries of origin (if known). However, the Statement identified that no company is required to describe its products as "DRC Conflict Free," "DRC conflict undeterminable" or "not found to be 'DRC Conflict Free.' "

United States District Court Ruling

As noted above, the final chapter in the litigation occurred on April 3, 2017, when the district court held that Section 1502 of the Dodd-Frank Act and the SEC conflict minerals rule violate the First Amendment to the extent that they require reporting companies to state that their products "have not been found to be 'DRC conflict free' " and remanded to the SEC to take action in accordance with the district court's ruling.

Next Steps: SEC and State Department Request for Comment

Earlier this year, SEC Acting Chairman Michael S. Piwowar issued two statements requesting comments regarding whether, in light of the then-ongoing litigation and the expiration of the transition period on January 1, 2017, the Statement should remain in effect and, more generally, whether the conflict minerals

rule has had an effect on the power and control of warlords in the Democratic Republic of the Congo and the adjacent region. Responsive comments were due to the SEC by March 17, 2017, for review in consideration of any possible changes to the conflict minerals rule. In light of the district court's decision, the Acting Chairman issued an additional statement on April 7, 2017, instructing the SEC staff to begin work on recommending future action by the SEC based on the district court's decision and based on the responses received in connection with the prior requests for comment.

In response to the Acting Chairman's statements at the beginning of the year, four senators from the Senate Banking Committee issued a letter to the SEC inspector general, requesting an investigation to determine whether Piwowar's order to the SEC staff to review the SEC conflict minerals rule was legally permissible.

On March 27, 2017, the State Department issued a terse "Notice of Stakeholder Consultations on Responsible Conflict Mineral Sourcing." The entire substance of the notice is contained in a single sentence. Specifically, the State Department "along with other agencies and departments is seeking input from stakeholders to inform recommendations of how best to support responsible sourcing of tin, tantalum, tungsten and gold." Comments are due by April 28, 2017.

On April 7, 2017, the SEC Division of Corporation Finance issued a statement (Recent Statement) regarding the enforcement of the conflict minerals rules, stating that it would not recommend an enforcement action against companies who choose to only file disclosure under the provisions of Item 1.01 (a) and (b) of Form SD, even those companies that are subject to Item 1.01(c) of Form SD. Pursuant to the Recent Statement the SEC is essentially stating that companies may choose to not engage in the additional due diligence requirements imposed by Item 1.01(c) of Form SD and to not file a Conflict Minerals Report as an attachment to the Form SD without fear of an SEC enforcement action. Notwithstanding the Recent Statement, the requirements remain in place and thus some companies may choose to comply with the terms of Item 1.01(c) of Form SD.

Draft Trump Executive Memorandum

Following Piwowar's statements, in early February 2017 a draft Executive Memorandum purportedly penned by President Trump's administration and titled "Suspension of the Conflict Minerals Rules" (the Memorandum) was leaked to the public. The Memorandum states that instead of limiting means of financing ongoing conflict in the Democratic Republic of the Congo, the disclosure requirements of the conflicts minerals rule have contributed to instability in the region and threatened US security interests. As permitted by Section 1502 of Dodd-Frank, citing national security interests, the Memorandum waives the disclosure and diligence requirements under the conflict minerals rule for a period of two years. The validity of the Memorandum remains uncertain, and (assuming it is authentic) we do not believe there is a high likelihood it will be formally adopted before May 31.

European Council Conflict Minerals Action

On the same day as the district court's ruling in *National Association of Manufacturers v. Securities and Exchange Commission*, the European Council formally adopted the European Union Parliament's conflict minerals regulation. Rather than imposing a reporting obligation on companies that sell products containing conflict minerals, the regulation applies to direct importers of minerals or metals containing tin, tantalum, tungsten and gold and requires those importers to perform due diligence to ensure that their supply chains are not financing armed conflict in "conflict-affected and high-risk areas." The regulation also imposes due diligence requirements on smelters and refiners of such materials operating in the European Union.

The obligations set forth in the regulation will become binding on affected companies effective January 1, 2021.

Reminders and Recommendations

- With the next Form SD due on May 31, 2017, most companies are far along (or have completed) their RCOI and, as necessary, due diligence. The Recent Statement permits, but does not require, companies to avoid reporting on the results of that due diligence in a conflict minerals report. Affected companies must consider whether to provide abbreviated reporting, and in doing so should bear in mind how investors and the NGO community will view a scaled-down disclosure.

- One potential area of uncertainty in light of the Recent Statement is what disclosure a company should make, if any, if it is *unable* to determine through its RCOI that its necessary conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country or did come from recycled or scrap sources. The majority of companies making Form SD filings in recent years have had to comply with Item 1.01(c) of Form SD by describing their diligence efforts and including a conflict minerals report. This presumably means they were unable to determine through their RCOI efforts whether their necessary conflict minerals originated in the Democratic Republic of the Congo or an adjoining country or came from recycled or scrap sources. Item 1.01(a) is the requirement to conduct RCOI and, as currently drafted, Item 1.01(b) applies when a registrant determines that its necessary conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country or did come from recycled or scrap sources. The Recent Statement does not give any specific guidance for companies that cannot make this determination, but presumably those companies can now choose to limit their disclosure to a description of their RCOI in Form SD and not make any public determination regarding the source of their minerals. That approach would be consistent with the outcome of the litigation and the Acting Chairman's First Amendment concerns.

- 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.

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

- Several socially responsible investors and NGO groups continue to express their dissatisfaction with the current state of conflict mineral reporting. 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 conflict minerals rule and their own specific views on best practices. Reporting companies may wish to stay abreast of where they stand in these rankings relative to peer companies.

- Reporting companies should consider joining a multi-stakeholder initiative, such as the Conflict-Free Sourcing Initiative, or an industry-specific group. Such a membership can help companies keep abreast of evolving best practices and other sources of conflict minerals.

The Recent Statement seems to be a stop-gap measure pending further action by the SEC commissioners. The impending appointment of Jay Clayton as SEC chairman is likely to lead to further action on the conflict minerals issue. Whether Section 1502 of Dodd-Frank is amended by Congress and whether the SEC will make changes to the reporting regime (either by rulemaking or the issuance of further interpretive guidance of some sort) remain to be seen. We continue to monitor these issues and will issue future alerts as circumstances require.

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