SHEARMAN & STERLING LLP

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All that Glitters… May Be a Reportable Conflict Mineral!

Conflict Minerals Rules: Frequently Asked Questions

The first reporting period for the US Securities and Exchange Commission's new Conflict Minerals Rules begins on January 1st. Under the new rules, SEC reporting companies that manufacture products that contain tantalum, tin, tungsten or gold face new reporting requirements. Those companies will be seeking information from private companies in their supply chains. Required by the Dodd-Frank Act, the Conflict Minerals Rules require disclosure of products that contain conflict minerals[1] originating in the Democratic Republic of the Congo and adjoining countries.[2] SEC reporting companies have been working to put in place controls and procedures to comply with the Conflict Minerals Rules and to ensure that minerals contained in their products are conflict-free.

The Conflict Minerals Rules take effect beginning with the 2013 calendar year. This means that SEC registrants will need to start tracking the source of the conflict minerals contained in their products starting January 1, 2013. The Conflict Minerals Rules will also affect companies that are not SEC registrants to the extent such companies supply products, components or materials to SEC registrants that are subject to the Conflict Minerals Rules. These companies will receive inquiries and requests for information and representations from downstream users regarding the source and chain of custody of the conflict minerals in the products they supply.

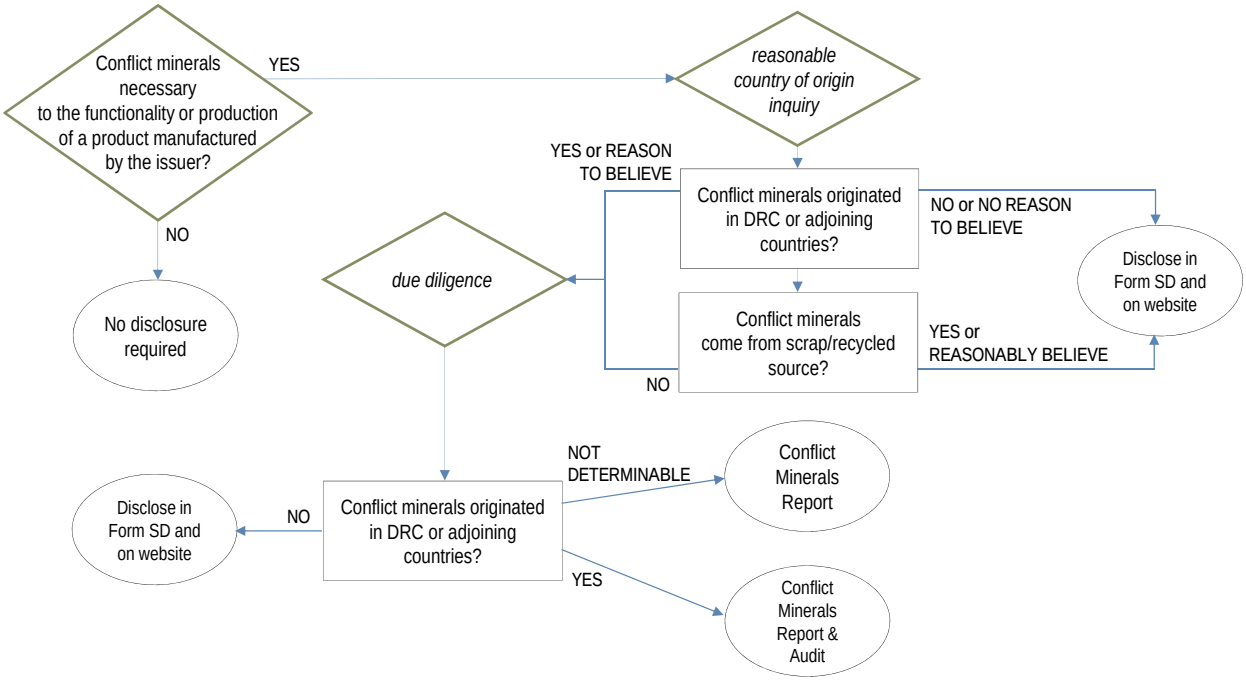
Companies have practical questions about designing and implementing a conflict minerals control framework. This Client Publication seeks to provide guidance, as well as to suggest some best practices for compliance. We anticipate that compliance practices will evolve over time, particularly as consensus views emerge with regard to the interpretation and implementation of the Conflict Minerals Rules. Our primary focus in this series of frequently asked questions is on how to get started, including:

[1] "Conflict minerals" is defined to mean tantalum, tin, tungsten and gold, regardless of whether such minerals finance conflict. Any SEC reporting company whose products contain any of these minerals is subject to the Conflict Minerals Rules. Additional minerals or their derivatives may be added to the definition of "conflict minerals" in the future if the Secretary of State determines that such minerals are financing conflict in the Covered Countries.

[2] These countries, which are referred to as the "Covered Countries", are the Democratic Republic of the Congo, Republic of the Congo, Central African Republic, South Sudan, Uganda, Rwanda, Burundi, Tanzania, Zambia and Angola.

- analyzing whether the Conflict Minerals Rules apply to your company,
- what is required by the "reasonable country of origin inquiry", and
- practical considerations for implementing a compliance framework.

The following diagram summarizes at a high level the three-step analysis that a company is required to make under the Conflict Minerals Rules to determine its level of SEC reporting:



For a more detailed review of the substantive provisions of the Conflict Minerals Rules, you may wish to refer to our previous Client Publication "*SEC Adopts Dodd-Frank Conflict Minerals and Government Payments Rules*" (August 27, 2012), available here.

I. Step One: Determine Whether the Conflict Minerals Rules Apply to Your Company

As a first step to determine whether a company is subject to the Conflict Minerals Rules, the company must determine whether it *manufactures* or *contracts to manufacture* any *products*.

The term "manufacture" is not defined in the rules and is to be interpreted as that term is commonly understood. Generally, a company would be considered to manufacture or contract to manufacture a product if the company has control or influence over the manufacturing process. A company has a conflict minerals reporting obligation with respect to components manufactured by third parties that are included in products it manufactures or contracts to manufacture.

Generally, an item would be considered a company's "product" if the company:

- causes the item to enter the stream of commerce and
- receives consideration in some form for the item.

If the company determines that it manufactures or contracts to manufacture any products, it will then need to ascertain whether any of those products contain conflict minerals that are necessary to the functionality or production of the product.

1. What is a "*product*" for purposes of the Conflict Minerals Rules?

- The final rule release provides little guidance regarding what is a "product" for purposes of the Conflict Minerals Rules. Generally, any item that a company enters into the stream of commerce by offering the item to third parties for consideration will be that company's product. As such, prototypes and other demonstration devices are not "products" for purposes of the Conflict Minerals Rules. A promotional item that is distributed for no consideration should generally not be considered a "product". However, a promotional item may be more likely to be the company's "product" if it is bundled with an item that the company sells. If the company manufactures or contracts to manufacture the product, the Conflict Minerals Rules will apply.[3]
- While the analysis of what is a "product" and whether a company "manufactures" or "contracts to manufacture" the product will depend on the particular facts and circumstances, the following series of questions analyzes some common fact patterns.

1.a. Is packaging considered to be part of the product? That is, is a company responsible for conflict minerals contained in the packaging of its products?

- There is no "bright line" rule for determining when a product's packaging is considered part of the product for purposes of the Conflict Minerals Rules. Until industry consensus is formed, companies will need to exercise judgment in determining whether the packaging for a particular product is something that the company is entering into the stream of commerce for consideration and is something that the company manufactures or contracts to manufacture.
- A company is less likely to have a conflict minerals reporting obligation with respect to its products' packaging where:
  - the packaging is generic, or
  - the packaging is used merely as a means of delivering the product, which is more likely to be the case with disposable packaging.
- Packaging is more likely to be subject to the Conflict Minerals Rules in cases where:
  - the producer of the product has a degree of influence over the manufacturing specifications of the product's packaging, as opposed to using generic packaging, or
  - the packaging adds to the value or marketability of the product, such as where:
    - the packaging is a promoted feature of the product,
    - the packaging helps the product to function better, or
    - the particular packaging is integral to the ability to sell the product.
- For example, where a media distributor for marketing reasons contracts and provides specifications for special metallic DVD cases (rather than using standard specification plastic DVD cases), the DVD case is more likely to

[3] The mining and sale of unrefined or unsmelted conflict minerals is not considered the "manufacture" of a "product" for purposes of the Conflict Minerals Rules.

be considered part of the product that the company is entering into the stream of commerce and be subject to the Conflict Minerals Rules. *See* Question # 3 below.

1.b. Our company sells media content (*e.g.*, software, video or music). Is the physical format by which the content is distributed (*e.g.*, CD or DVD) considered part of the product?

- If media content, such as software, video or music, is distributed in physical form, such as on a CD or DVD, the physical medium would likely be considered part of the company's product. However, the CD or DVD would only be subject to conflict minerals reporting if the media content provider manufactured or contracted to manufacture the physical CD or DVD. If the media content provider merely purchases generic blank CDs and DVDs on which to write its media content, and otherwise has no influence on the manufacturing of the blank CDs or DVDs, it is less likely that the company contracts to manufacture the CDs or DVDs and, accordingly, less likely that the Conflict Minerals Rules would apply.

1.c. Our company from time to time resells obsolete equipment and fixtures (for example, when we close a factory or store) that we don't consider to be our primary products. Are we responsible for reporting on the conflict minerals contained in such items?

- While there is no SEC guidance yet on this question, we think it would be reasonable to take the position that a company's "products" for purposes of the Conflict Minerals Rules should be limited to those items that the company holds itself out as producing and/or selling, such as in its public disclosure and marketing materials. Accordingly, to the extent that resales of obsolete equipment or inventory are merely incidental to the company's business and sources of revenue, they are less likely to be considered the company's "product".
- For example, based on this reasoning, we do not believe that a department store should be responsible for reporting on the conflict minerals contained in store fixtures that are resold when a store is closed or remodeled. Similarly, in the case of a telecommunications network operator that resells obsolete network infrastructure from time to time, such items generally should not be considered the company's "products" if such resales do not make up a meaningful source of revenue for the company.

1.d. Our company licenses our intellectual property to third parties that manufacture products. Are we responsible for conflict minerals reporting for such products?

- Generally, a licensor should not have a reporting obligation under the Conflict Minerals Rules with respect to products of the licensee.
- However, the more similar a license arrangement is to contracting to manufacture products, the more likely it would be that the licensor would have a conflict minerals reporting obligation with respect to the licensed products. To the extent that the license gives the licensor influence on the manufacture of a product, or if the license fees are based on the net income of the licensee, rather than on sales of the licensed products, the licensor may be considered to be contracting to manufacture the product and in such case would likely be subject to the Conflict Minerals Rules.
- For example, if a company licenses its brand to a third party that manufactures and sells watches bearing the brand, and the license includes terms relating to the manufacturing specifications of the watches - such as that they must contain a certain amount of gold – depending on the specific facts, the licensor should consider whether this could constitute "contracting to manufacture" the watches. However, if the company licenses its

brand to such a third party watch manufacturer and the license includes a provision that any gold used in the watches cannot be sourced from the Covered Countries, that alone would not trigger a conflict minerals reporting obligation.

1.e. Our company provides services using equipment and other infrastructure that contain conflict minerals. Are we responsible for conflict minerals reporting for such equipment or infrastructure if we do not sell it as our product?

- No. For example, a telecommunications network provider should not be subject to the Conflict Minerals Rules with respect to its network infrastructure (such as cables or cell phone towers). Similarly, an airline company should not be subject to the Conflict Minerals Rules with respect to its aircraft. In these cases, it is the service the company provides, and not the equipment or other infrastructure it uses to provide the service, that should be considered the company's "product" that it is entering into the stream of commerce for consideration.
- If a service provider manufactures or contracts to manufacture items that it sells to its customers, such items are more likely to be considered "products" for purposes of the Conflict Minerals Rules. For example, if a cable television provider contracts to manufacture set-top boxes that it sells to its customers, it should consider whether the set-top box is its "product" for which it has a conflict minerals reporting obligation.
- If a company leases equipment or other infrastructure to customers in order to deliver a service, whether the leased items would be considered the company's "products" will depend on the particular facts and circumstances, including the nature of the lease. For example, if the economic effect of the lease is substantially equivalent to a sale, the item would be more likely to be considered a "product".

2. Our company assembles products from components manufactured by third parties. Does assembly of a product constitute "*manufacturing*" for purposes of the Conflict Minerals Rules?

- Yes. Companies that manufacture products through assembly are subject to the Conflict Minerals Rules.

3. What does "*contract to manufacture*" mean for purposes of the Conflict Minerals Rules? What level of influence over the manufacturing process would be considered *contracting to manufacture*?

- Whether a company "contracts to manufacture" a product or component for purposes of the Conflict Minerals Rules depends on the degree of influence exercised by the company on the manufacturing of the product or component. The more actual influence that the company exercises over the materials, parts, ingredients or components to be included in a product, the more likely it is that the company "contracts to manufacture" the product. The determination is based on the individual facts and circumstances surrounding the company's business and industry.
- The final rule release provides some guidance as to when a company's involvement does *not* constitute "contracting to manufacture":
  - specifying or negotiating contractual terms with a manufacturer that do not directly relate to the manufacturing of the product
    - for example, training or technical support, price, insurance, indemnity, intellectual property rights, dispute resolution, or other like terms or conditions concerning the product
    - *unless* the intent or effect of such terms is to exercise a degree of influence over the manufacturing of the product that is practically equivalent to contracting on terms that directly relate to the manufacturing of the product

- affixing its brand, marks, logo, or label to a generic product manufactured by a third party
- servicing, maintaining, or repairing a product manufactured by a third party

- For example, a telecommunications network carrier that specifies to a manufacturer of mobile phone handsets that the carrier will purchase from the manufacturer to sell at retail that the handset must be able to function on the carrier's network is not sufficient influence over the manufacturing of the handset device to constitute "contracting to manufacture" for purposes of the Conflict Minerals Rules.
- A company that is a pure retailer or that offers generic products under its own brand, without additional involvement in the manufacture of the products, is not considered to "contract to manufacture" the products it sells and is not subject to conflict minerals reporting with respect to those products.
- To the extent that a company's rights or influence affect the likelihood that a conflict mineral is included in a product, the more likely it is that this influence will constitute "contracting to manufacture" for purposes of the Conflict Minerals Rules.
- While not free from doubt, in our view requiring a representation from a manufacturer that its product does not contain conflict minerals, without more, should not constitute "contracting to manufacture".

4. Our company has some products that are manufactured by joint ventures or investees that we do not control. Do we have a conflict minerals reporting obligation with respect to these products?

- The final rule release does not address this question. The Conflict Minerals Rules do not explicitly refer to the "affiliate" concept used in certain other SEC disclosure rules. A company should not be required to report on behalf of joint ventures that it does not control or minority investments that it does not control. As such, it would be reasonable to take the position that a company is only responsible for conflict minerals reporting with respect to products manufactured or contracted to be manufactured by subsidiaries that are consolidated for financial reporting purposes or over which it controls the manufacturing process.
- In cases where a company concludes that it has a conflict minerals reporting obligation with respect to a joint venture or minority investments, in either case, that it controls and/or consolidates for financial reporting purposes, the company should ensure that it has a right to access the information necessary to comply with its conflict minerals reporting obligation.
- The Conflict Minerals Rules provide a phase-in period when an SEC reporting company acquires another company that manufactures or contracts to manufacture products containing conflict minerals. The rules allow the acquiring company to delay the initial conflict minerals reporting period with respect to such products until the first calendar year beginning no sooner than eight months after the effective date of the acquisition.

5. Conflict minerals are contained in, or are used to produce, certain of our products. Which of these products are subject to conflict minerals reporting?

- The Conflict Minerals Rules apply to a particular product only if the final product actually contains conflict minerals in any amount. The scope of the Conflict Mineral Rules is further limited to conflict minerals that are "necessary to the functionality" of the product or that are "necessary to the production" of the product. However, as discussed in Questions # 6 and 7 below, the rules provide little concrete guidance as to when conflict minerals are necessary to the functionality or production of a product. As a practical matter, then, companies are likely to focus more on whether their products contain any conflict minerals.

6. What does it mean for a conflict mineral to be *necessary to the functionality* of a product?

- The final rule release provides some guidance as to when conflict minerals are "necessary to the functionality" of a product. In determining whether conflict minerals are necessary to the functionality of a product, the following factors should be considered:
  - whether a conflict mineral is *intentionally added* to the product or any component of the product – in which case, the Conflict Minerals Rules apply – or is a naturally-occurring by-product – in which case, the Conflict Minerals Rules do not apply
  - whether a conflict mineral is necessary to the product's *generally expected function, use or purpose*
    - The SEC expressly rejected the proposal by some commentators to limit "necessary to the functionality" to whether conflict minerals are necessary to a product's "basic function" or "economic utility".
    - Where a product has more than one generally expected function, use or purpose (such as a smart phone that can make and receive phone calls, access the internet and play stored music), the Conflict Minerals Rules apply if conflict minerals are necessary to any one such generally expected function, use or purpose.
    - Whether the conflict mineral is required either for the marketability or financial success of the product may be one factor that should be considered as part of this analysis.
  - if a conflict mineral is incorporated for purposes of ornamentation, decoration or embellishment, the Conflict Minerals Rules would apply if the primary purpose of the product is ornamentation or decoration, such as jewelry
    - For example, if an item of clothing contains gold for ornamental or decorative purposes, the product would likely not be subject to the Conflict Minerals Rules, as generally speaking the primary purpose of most clothing is not mainly for ornamentation or decoration. However, a zipper or button on an item of clothing that contains conflict minerals may be necessary to the functionality of the clothing, in which case the Conflict Minerals Rules may apply.

7. What does it mean for a conflict mineral to be *necessary to the production* of a product?

- In assessing whether conflict minerals are "necessary to the production" of a product, conflict minerals in tools or machines or indirect equipment used to produce the product, such as a computer, do not trigger the Conflict Minerals Rules.

8. In determining whether our company's products contain any conflict minerals, to what extent can we reasonably rely on representations from our suppliers?

- The inquiry that a company must undertake to determine as a threshold matter whether its products contain conflict minerals will in many cases start internally, with interviews of, or questionnaires sent to, the people within the organization that have knowledge of the product's design and manufacture, the product's supply chain and/or the procurement process.

- In some instances, the company will need to extend this inquiry to its first-tier suppliers and further back the supply chain. This inquiry of the company's suppliers may take the form of questionnaires or "flow-down" clauses in contracts with suppliers, in each case designed to provide assurance as to whether the components or products supplied contain conflict minerals that are necessary to the functionality or production of the final product and, if so, whether those conflict minerals originated in the Covered Countries.[4]
- Companies may reasonably rely on representations from suppliers but cannot turn a blind eye to risks or red flags. It would generally be reasonable to rely on representations from suppliers that are themselves SEC reporting companies or subject to similar developed transparency and regulatory regimes in other countries. There may be a higher degree of risk with respect to suppliers based in jurisdictions where regulation is less developed.
- As inquiries of, and representations from, suppliers will typically also form part of the reasonable country of origin inquiry that a company must undertake if any of its products contain conflict minerals, the considerations discussed in Question # 11 will also be relevant to this step.

9. What standard of inquiry is required to determine whether our company is subject to the Conflict Minerals Rules?

- The Conflict Minerals Rules do not prescribe a standard of inquiry that a company must satisfy in order to determine whether it manufactures or contracts to manufacture products that contain conflict minerals. Like other SEC reporting requirements, companies are expected to act in good faith and use reasonable efforts to put in place compliance and disclosure controls reasonably designed to provide assurance that the company is in compliance with the Conflict Minerals Rules.

II. Step Two: Reasonable Country of Origin Inquiry

If a company determines that it is subject to the Conflict Minerals Rules because conflict minerals are contained in, and are necessary to the functionality or production of, a product manufactured or contracted to be manufactured by the company, the company will be required to make a *reasonable country of origin inquiry* to determine whether the conflict minerals in its products originated in the Covered Countries or came from recycled or scrap sources.

10. What is a "reasonable country of origin inquiry"?

- While the Conflict Minerals Rules do not prescribe what steps are necessary to satisfy the reasonable country of origin inquiry requirement, they do provide general standards for the reasonable country of origin inquiry. The inquiry must be reasonably designed to determine whether the company's conflict minerals either:

  i. did originate in the Covered Countries or

  ii. did come from recycled or scrap sources.

  Further, the inquiry must be performed in good faith.

[4] The Electronic Industry Citizenship Coalition (EICC) and Global e-Sustainability Initiative (GeSI) Conflict Free Smelter initiative has developed a template questionnaire that can be sent to suppliers. See http://www.conflictfreesmelter.org/ConflictMineralsReportingTemplateDashboard.htm (accessed November 28, 2012).

- What constitutes a reasonable country of origin inquiry will depend on each company's particular facts and circumstances and may differ among companies based on the company's size, products, relationships with suppliers or other factors. Furthermore, the reasonable country of origin inquiry standard depends on the available infrastructure at a given time and will evolve over time as the available infrastructure develops.
- One way that would satisfy the reasonable country of origin inquiry standard is if the company seeks and obtains reasonably reliable representations from its suppliers indicating:
  - the facility at which the conflict minerals were processed, and
  - demonstrating that those conflict minerals either did not originate in the Covered Countries or were from recycled or scrap sources
    - Certifications of mineral processing facilities by independent organizations as a result of an audit, such as the EICC-GeSI conflict-free smelter designation, could form an important part of the basis for this determination.[5]
- Some industry groups are preparing industry-specific standard supplier representations.
- However, in providing guidance on the reasonable country of origin inquiry standard, the final rule release states that companies cannot turn a blind eye to warning signs or red flags indicating that the representations may not be reliable and that the conflict minerals may have originated in the Covered Countries or may not have come from recycled or scrap sources.
- A company's conflict minerals sourcing policy will generally also form an important part of the reasonable country of origin inquiry.

11. Supplier Inquiries and Representations

11.a. Do we need to make inquiries of all of our suppliers?

- A company's reasonable country of origin inquiry must be reasonably designed to determine the source of the company's conflict minerals. Relying on a sampling of the company's suppliers would not be sufficient. As a practical matter, we expect companies will try to ask all of their direct suppliers.

11.b. Do we need to track the conflict minerals supply chain further upstream than our first-tier suppliers?

- The answer will largely depend on the responses and representations received from the initial inquiry of the company's first-tier suppliers. If the responses received from the company's first-tier suppliers are inconclusive or raise red flags, it may be appropriate to extend the inquiry to suppliers further upstream the supply chain.

[5] See http://www.conflictfreesmelter.org/ (accessed on November 29, 2012).

11.c. Can we reasonably rely on "flat reps" from our suppliers that the conflict minerals did not originate in the Covered Countries?

- It would generally be reasonable to rely on representations from suppliers that are themselves SEC reporting companies or subject to similar developed transparency and regulatory regimes in other countries. However, it may be reasonable or appropriate to request information regarding the supplier's basis for concluding that the conflict minerals did not originate in the Covered Countries.

11.d. What if some suppliers don't respond to our inquiries?

- While the reasonable country of origin inquiry standard does not require a company to determine with certainty the origin of all of its conflict minerals (*see* Question # 12 below), if a supplier that accounts for a significant amount of the company's conflict minerals does not respond to the company's inquiries, this may in itself constitute a red flag warranting further due diligence.

12. Are we required to determine with certainty the origin of all of the conflict minerals contained in all of our products?

- The reasonable country of origin inquiry is a reasonableness standard. As long as the inquiry is reasonably designed and carried out in good faith and the company does not ignore warning signs or red flags, the standard will be satisfied — even if the company does not hear from all of its suppliers or if the origin of a small amount of the company's conflict minerals remains unknown.

13. What is the difference between the *reasonable country of origin inquiry* standard (Step Two) and the *due diligence* required if a company has reason to believe that its conflict minerals may have originated in the Covered Countries or may not have come from recycled or scrap sources (Step Three)?

- The reasonable country of origin inquiry is a lower standard of inquiry than the due diligence required if the company has reason to believe that some of its conflict minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources.
- As a practical matter, some companies that know their products contain conflict minerals, but have not yet put in place controls to determine the origin of their conflict minerals, are preparing to undertake conflict minerals supply chain due diligence. The reason for this is, if a company identifies a "red flag" or other warning sign that gives it reason to believe that its conflict minerals may have come from the Covered Countries only late in the calendar year, it will have less time at that point to conduct the required due diligence (which may involve an independent audit) and prepare the Conflict Minerals Report.

14. What is required if, based on our reasonable country of origin inquiry, we are unable to determine the origin of certain of the conflict minerals contained in our products? That is, when is due diligence required?

- If, based on a company's reasonable country of origin inquiry, the company either:
  - has *no reason to believe* that its conflict minerals may have come from the Covered Countries, or
  - *reasonably believes* that its conflict minerals are from recycled or scrap sources,

then the company is only required to file a Form SD that discloses this determination and briefly describes the country of origin inquiry it undertook and the results of the inquiry. In this case, the company is not required to undertake conflict minerals supply chain due diligence and file a Conflict Minerals Report.

- Conversely, if, based on the reasonable country of origin inquiry, the company either knows that its conflict minerals originated in the Covered Countries or *has reason to believe* that its conflict minerals may have originated in the Covered Countries (and may not have come from recycled or scrap sources), then the company must proceed to the supply chain due diligence step.
- In short, a company is not required to prove that its conflict minerals did not come from the Covered Countries in order to avoid the due diligence requirement. However, companies are not permitted to ignore red flags that could give a reason to believe that the conflict minerals may have come from the Covered Countries. If such a "reason to believe" exists, the company must undertake due diligence on its conflict minerals supply chain.

15. What are warning signs or "red flags" that could give rise to a reason to believe that conflict minerals in our products may have come from the Covered Countries?

- One example of a "red flag" would be if a company traces its conflict minerals to a particular smelter or refinery that processes minerals from a number of different countries, including the Covered Countries, but the company is unable to determine whether its conflict minerals received from that processing facility were from the Covered Countries. The OECD's *Due Diligence Guidance* provides other examples of red flags.[6]
- In particular in the context of assessing the reliability of representations from suppliers that are not SEC reporting companies or not subject to similar developed transparency and regulatory regimes in other countries, the risk-based due diligence principles and procedures used in the anti-corruption compliance (*e.g.*, FCPA) context may inform the conflict minerals compliance process.

16. How do the Conflict Minerals Rules treat conflict minerals from recycled or scrap sources? How do the Conflict Minerals Rules define *recycled* or *scrap* minerals?

- Products containing conflict minerals from recycled or scrap sources may be described as "DRC conflict free" and do not trigger the requirement to conduct supply chain due diligence and prepare and file a Conflict Minerals Report.
- Under the Conflict Minerals Rules, conflict minerals are considered to be from recycled or scrap sources if they are from:
  - *recycled metals*, which are reclaimed end-user or post-consumer products, or
  - *scrap processed metals* created during product manufacturing.

[6] See *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas*, http://www.oecd.org/investment/guidelinesformultinationalenterprises/46740847.pdf (accessed on December 3, 2012).

- Recycled metal includes excess, obsolete, defective, and scrap metal materials that contain refined or processed metals that are appropriate to recycle in the production of tin, tantalum, tungsten and/or gold.
- Minerals partially processed, unprocessed, or a bi-product from another ore are not included in the definition of recycled metal.

III. Step Three: Due Diligence and Conflict Minerals Report

If a company, based on its reasonable country of origin inquiry, determines that its conflict minerals did originate, or has reason to believe that such minerals may have originated, in the Covered Countries and are not from recycled or scrap sources, it is required to undertake further due diligence on the source and chain of custody of its conflict minerals.

17. What does "*due diligence*" require?

- The due diligence inquiry a company undertakes to determine the source and chain of custody of its conflict minerals is required to follow a nationally or internationally recognized due diligence framework.
- The Organisation for Economic Co-operation and Development (OECD) has adopted *Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas*, together with a supplement on tin, tantalum and tungsten and a supplement on gold.[7] The final rule release expressly provides that the OECD's *Due Diligence Guidance* satisfies the criteria of the Conflict Minerals Rules, and they are currently the only nationally or internationally recognized due diligence framework for tin, tantalum, tungsten and gold conflict mineral supply chain due diligence.

18. What is required if the outcome of our conflict minerals due diligence is:

a. We determine that our conflict minerals either did not originate in the Covered Countries or did come from recycled or scrap sources.

- The company is required to file a Form SD that:
  - discloses the company's conclusion
  - briefly describes the reasonable country of origin inquiry and the due diligence that the company exercised
  - briefly describes the results of the country of origin inquiry and due diligence to demonstrate why the company believes that the conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources
- No Conflict Minerals Report or independent audit is required.

[7] See http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/mining.htm# (accessed on December 10, 2012).

b. We are unable to determine the source of our conflict minerals.

- During a temporary period (calendar years 2013 and 2014, or calendar years 2013 through 2016 for smaller reporting companies), a company may describe its products as "DRC conflict undeterminable" if, based on the company's due diligence, it is unable to determine:
  - that its conflict minerals did not originate in the Covered Countries,
  - that its conflict minerals that did originate in the Covered Countries did not directly or indirectly finance or benefit armed groups, or
  - that its conflict minerals came from recycled or scrap sources.
- A Conflict Minerals Report is required, but no independent audit is required.
  - The Conflict Minerals Report must include a description of the steps the company has taken or will take, if any, since the end of the period covered in its most recent prior Conflict Minerals Report to mitigate the risk that its necessary conflict minerals benefit armed groups, including any steps to improve its due diligence.

c. We determine or still have reason to believe that our conflict minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources.

- The company is required to file a Conflict Minerals Report that includes a description of the measures the company has taken to exercise due diligence.
- Unless the company's products are "DRC conflict free", the Conflict Minerals Report must also include a description of:
  - the facilities used to process those conflict minerals (*i.e.*, the smelter or refinery),
  - the country of origin of those conflict minerals,
  - the efforts to determine the mine or location of origin with the greatest possible specificity, and
  - the products that are not "DRC conflict free"
- A certified independent private sector audit is required.

19. What is an *independent private sector audit*? Who can perform the audit?

- The objective of the independent private sector audit is to express an opinion as to:
  - whether the design of the company's due diligence framework as set forth in its Conflict Minerals Report is in conformity with, in all material respects, the criteria set forth in the nationally or internationally recognized due diligence framework used by the company, and
  - whether the company's description of the due diligence measures it performed as set forth in its Conflict Minerals Report is consistent with the due diligence process that the company undertook.
- The audit standards for the independent private sector audit of the Conflict Minerals Report are set by the Government Accountability Office, which has indicated that its existing Government Auditing Standards (GAGAS) will apply.
- Under SEC independence requirements, a company's independent public accountant may also perform the independent private sector audit of the Conflict Minerals Report. However, the engagement to perform the

conflict minerals audit would be considered a "non-audit service" subject to the pre-approval requirements of Rule 2-01(c)(7) of Regulation S-X.

- If a company uses an independent consultant to assist the company in conducting its conflict minerals due diligence and preparing its Conflict Minerals Report, the company may need to use a different firm to perform the independent audit of the Conflict Minerals Report.

IV. Compliance Framework and Management

20. What should every company that is subject to the reporting requirements of the Securities Exchange Act of 1934 do to ensure compliance with the Conflict Minerals Rules? By when?

- Companies should first consider whether they manufacture or contract to manufacture any products. If a company knows that it does not, the Conflict Minerals Rules will not apply.
- One way to determine whether the Conflict Minerals Rules apply to the company is to send a short questionnaire to the responsible heads of business units within the company with questions designed to determine whether the company manufactures or contracts to manufacture any products and, if so, if any of those products contain conflict minerals.
- Companies should undertake this threshold inquiry as soon as possible. If a company determines that it is subject to the Conflict Minerals Rules because it manufactures or contracts to manufacture products that contain conflict minerals that are necessary to the functionality or production of the product, it may need to put in place conflict minerals supply chain controls and procedures with respect to the calendar year 2013.

21. Who within our organization should ultimately be responsible for overseeing the implementation of conflict minerals compliance processes and controls?

- Because the disclosures required under the Conflict Minerals Rules will subject the company to additional potential liability under US securities laws, and the implementation of a conflict minerals compliance framework will necessarily be an enterprise-wide endeavor, the initiative should be led from the top. Executive level decisions may be required concerning sources of supply, and compliance with the Conflict Minerals Rules could affect the company financially, as well as its reputation.
- Accordingly, the board should determine, based on an assessment of the potential conflict mineral use profile of the company, who should have responsibility for oversight of the design and implementation of internal controls for compliance with the Conflict Minerals Rules. For some companies, it may be appropriate for the chief financial officer, and ultimately the audit committee, to have that responsibility. A company's public disclosures pursuant to the Conflict Minerals Rules should be subject to the company's disclosure controls and procedures, and, as such, the disclosure committee should be involved. For many companies, the corporate social responsibility committee and/or sustainability committee, or similar board committees, would also be involved in the process.
- It is best practice for companies that manufacture or contract to manufacture products to have a conflict minerals policy, which should set out compliance and oversight responsibilities.

22. Our company received components containing conflict minerals in the 2013 calendar year, but our products containing those components will not be finished until sometime during the 2014 calendar year. For which period are we required to report these conflict minerals?

- The conflict minerals reporting obligation with respect to a product is determined by the period in which the manufacture of the product is completed, regardless of whether the company manufactures the product or contracts to have the product manufactured. In this case, the company must provide its required conflict minerals information for the 2014 calendar year.

23. We have conflict minerals in our supply chain and/or stockpiles of conflict minerals as of January 31, 2013. Are we required to report on these conflict minerals?

- The Conflict Minerals Rules exempt conflict minerals that, prior to January 31, 2013:
  - have already been smelted (for columbite-tantalite, cassiterite or wolframite[8]) or fully refined (for gold), or
  - for any conflict mineral, or its derivatives, that has not been smelted or fully refined, are located outside of the Covered Countries.

24. What are other companies doing to implement controls for compliance with the Conflict Minerals Rules?

- The degree of action to implement a conflict minerals compliance framework has so far been varied, with companies in the manufacturing, automotive, electronics and jewelry sectors the most advanced. Many of the companies that are most directly affected by the Conflict Minerals Rules are participating in initiatives led by industry associations to develop industry consensus and best practices.
- Affected companies are adopting conflict minerals policies and are undertaking the first step in the compliance analysis by having business units respond to an initial questionnaire designed to determine if the company manufactures or contracts to manufacture any products, and, if so, if any of those products contain conflict minerals (*see* Question # 20 above).
- Some issuers, in particular manufacturing companies that already know that their products contain conflict minerals, pending the results of the reasonable country of origin inquiry, are proceeding on the basis that they may be required to prepare a conflict minerals report and are considering how to implement the required due diligence and what form the disclosures in the conflict minerals report will take.

25. Could the SEC disagree with our analysis of how the Conflict Minerals Rules apply to our company's products? What are the implications of this, assuming our analysis and conclusions are made in good faith?

- At this stage, it is not yet known what form the SEC's review of compliance with the Conflict Minerals Rules will take. At least initially, it is likely that the SEC's review will focus on a company's disclosures and other information in the public domain relating to the company's conflict minerals sourcing and comment on the

[8] The metal ores from which tantalum, tin and tungsten, respectively, are extracted.

company's compliance with the Conflict Minerals Rules form requirements on the basis of this information. For example, the SEC Staff could question a company's conclusion that it is not subject to the Conflict Minerals Rules if there are news reports or public statements from NGOs regarding the company's use of conflict minerals.

- Until the SEC provides further guidance on this question, a late filing of Form SD may affect a company's eligibility to use shelf registration for offering of securities on Form S-3 or Form F-3. One of the eligibility requirements for using Form S-3 or Form F-3 to offer securities using the shelf registration process is that the company must have "filed in a timely manner all reports required to be filed during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement".

26. Do we have to maintain records documenting our company's compliance with the Conflict Minerals Rules?

- The Conflict Minerals Rules do not require that a company maintain reviewable business records supporting its conclusions from its reasonable country of origin inquiry or due diligence.
- However, maintenance of appropriate records, for example pursuant to the company's general document retention policy, would be useful in evidencing compliance with the Conflict Minerals Rules, and should form part of the conflict minerals due diligence framework applied by the company. Accordingly, we recommend that a company retain contemporaneously prepared records that document its reasonable country of origin inquiry and due diligence inquiry. Companies should consider following a document retention policy of retaining such records for at least five to eight years, to ensure that documents are retained for a period at least until applicable statutes of limitations expire.

V. Other Matters

27. Does the conflict minerals disclosure need to be included in registration statements for securities offerings? Does it need to be included in offering documents in Rule 144A offerings?

- The Conflict Minerals Rules do not require the inclusion of a company's conflict minerals disclosure in the company's registration statements or prospectuses for securities offerings.
- For purposes of assessing whether disclosure regarding a company's conflict minerals sourcing should be included in an offering document, whether in an SEC-registered offering or in a Rule 144A offering, this information should be evaluated according to the general anti-fraud requirement that an offering document must contain all information that is material to a decision to invest in the securities being offered and may not contain any omission of a material fact. The fact that the SEC does not require conflict minerals information to be included in an issuer's annual report on Form 10-K, 20-F or 40-F, while helpful, is not determinative of materiality.
- In some cases, information regarding a company's conflict minerals sourcing may be material, for example because changes in a company's sourcing policies could have a material financial effect, because it highlights reputational risks or because certain institutional investors have policies that prohibit them from investing in companies that do not follow responsible conflict minerals sourcing.

28. How could the legal challenge recently brought by the National Association of Manufacturers and the US Chamber of Commerce affect the implementation of the Conflict Minerals Rules?

- On October 19, 2012, the National Association of Manufacturers and the US Chamber of Commerce filed a petition with the US Court of Appeals for the D.C. Circuit challenging the SEC's rulemaking under Section 1502 of the Dodd-Frank Act. In connection with legal challenges brought against other provisions of the Dodd-Frank Act, the rules subject to challenge have been stayed pending judicial review, and in some cases the reviewing court has overturned the rulemaking.
- However, at this time no action has been taken to stay the Conflict Minerals Rules, and we recommend that, notwithstanding the legal challenge, companies proceed with implementing their conflict minerals compliance framework assuming the Conflict Minerals Rules will come into effect as planned. Even if the Conflict Minerals Rules are ultimately amended or overturned as a result of the legal challenge, companies are coming under increasing pressure to be more transparent regarding their conflict minerals sourcing.

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The views set forth in this memorandum are based on the SEC's final rule release adopting the Conflict Minerals Rules, as augmented by discussions with market participants involved in following developments in this area, and are subject to any further guidance or other statements of the SEC clarifying these questions.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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