

# The Complete Compliance and Ethics Manual 2022

## Complying with the SEC's Conflict Minerals Rule: An Overview for Compliance Professionals

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### Overview of the Conflict Minerals Rule

On August 22, 2012, the United States Securities and Exchange Commission (SEC) adopted Rule 13p-1<sup>[2]</sup> under the Securities Exchange Act of 1934, as required by Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Rule 13p-1 and Form SD adopted pursuant to that rule, which are together commonly referred to as the Conflict Minerals Rule, require public companies to determine whether tin, tantalum, tungsten, or gold are contained in the products that they manufacture or contract to manufacture and, if they are contained in the products, whether they are necessary to their functionality or production. If so, the company must take steps to determine and make specified disclosures concerning, among other things, the source of the minerals. Heightened due diligence and reporting is required by the rule to the extent that the conflict minerals originate in the Democratic Republic of the Congo (DRC) or one of its adjoining countries.

The rule is intended to reduce a significant source of funding for armed groups that are committing human rights abuses, particularly in the eastern DRC.

### Companies Affected by the Rule

The rule potentially applies to all SEC reporting companies other than investment companies. All companies that file reports with the SEC under Section 13(a) or 15(d) of the Exchange Act, including foreign private issuers, emerging growth companies, smaller reporting companies, and voluntary filers are subject to the rule. The rule, however, does not apply to OTCQX<sup>[3]</sup> International and other issuers that are exempt from Exchange Act reporting pursuant to Rule 12g3-2(b) under the Exchange Act. The rule applies to not only the public registrant, but also to all of its consolidated subsidiaries. In this article, the term “company” generally refers to a company and its consolidated subsidiaries.

Mining activities are not covered by the rule, and companies engaged solely in activities commonly associated with mining, such as transporting, crushing, and milling ore, do not have any reporting obligations under the rule.

Given the broad applicability and scope of the rule, even if a public company ultimately does not have a reporting obligation under the rule, it first must still determine whether it uses conflict minerals in a way that triggers the application of the rule.

Private companies that are acquired by public companies and newly public companies can take advantage of a transition period before they are subject to the rule. The rule provides that a public company that acquires a non-reporting company does not have to report on the acquired company's in-scope products until the calendar year that begins no sooner than eight months after the effective date of the acquisition. For example, if a public company acquires a private company during July 2019, it would not be required to report on the acquired company's conflict minerals usage until calendar 2021. The staff of the SEC has stated in an FAQ that it will not

object if a newly public company begins reporting on conflict minerals usage on this same timetable.

Although private companies are not directly subject to the rule, they are indirectly affected by the rule to the extent that they are part of a public company's supply chain and will therefore need to follow many of the same compliance procedures as public companies. Public companies that do not have a filing obligation under the rule also may be subject to similar customer requirements.

## **Filing Requirements**

SEC reporting companies with in-scope products are required to file a Form SD with the SEC. Affected public companies must file a Form SD annually by May 31 of each year, covering the most recently completed calendar year.

Failure to timely file a Form SD does not affect a company's eligibility to use Form S-3. Furthermore, the Form SD will not be incorporated by reference into a company's registration statements under the Securities Act unless the company so elects.

## **Conflict Minerals Defined**

The term "conflict minerals" is defined in the rule. It refers to gold and cassiterite, columbite-tantalite (also known as coltan), wolframite, and three specified derivatives: tin, tantalum, and tungsten. The minerals covered by the rule are referred to frequently as 3TG. The rule targets these particular minerals because of their connection at the time the rule was adopted to armed groups committing human rights abuses in the DRC and certain of its adjoining countries.

Additional minerals or their derivatives may be added to the definition if the U.S. Secretary of State determines that they are financing conflict in the DRC or any of its adjoining countries. However, it is unlikely that this will occur in the foreseeable future.

## **Covered Countries**

The rule is focused on the DRC and its adjoining countries, which are:

1. Angola
2. Burundi
3. Central African Republic
4. the Republic of the Congo
5. Rwanda
6. South Sudan
7. Tanzania
8. Uganda
9. Zambia

The DRC and its adjoining countries are often referred to as the "covered countries."

## A Compliance Roadmap

The rule requires companies to conduct up to a three-step inquiry. The results of each of the first two steps will determine whether the company is required to continue to the next step. In almost all cases, companies will require assistance from their suppliers to obtain the information they need for purposes of complying with the rule. Most companies circulate questionnaires to their suppliers or use an equivalent software solution to obtain the information. The Responsible Minerals Initiative has put together a complimentary supplier questionnaire template, known as the conflict minerals reporting template, that companies can use. Most companies use this questionnaire.

### Step 1: Determining Whether the Company's Activities and Products are Covered by the Rule

Step 1 of the inquiry involves determining whether conflict minerals are contained in products that are manufactured or contracted to be manufactured by the company and, if so, whether those conflict minerals are necessary to the functionality or production of the products. If they are not, the company has no obligation to file a Form SD or conduct further inquiries under the rule. Furthermore, any out-of-scope conflict minerals and products are excluded from a company's reporting obligations under the rule.

All companies addressing compliance with the rule for the first time should conduct a thorough internal review for potentially in-scope products. Companies already subject to the rule in prior years will need to review new or modified products to determine whether they are in-scope.

**1. Determining Product Status.** The rule does not contain a definition of product, although the SEC has provided some guidance as to what constitutes a product.

The SEC has indicated in an FAQ that, for purposes of the rule, capital equipment, such as tools and machines, or other equipment used in the manufacture of products that is resold is not a product of the manufacturer of the products produced with the equipment.

A question that arises for some service businesses is whether physical items related to providing the service are products within the meaning of the rule. The SEC has provided some guidance in this regard, noting that a company is not required to report on conflict minerals contained in equipment that it manufactures or contracts to manufacture to the extent that the equipment is used for a service provided by the company and the equipment: is

1. Retained by the service provider;
2. To be returned to the service provider; or
3. Intended to be abandoned by the customer following the terms of service.

**2. Inclusion of Conflict Minerals in the Product.** For a product to be in-scope, the conflict minerals must be contained in the product. There is no de minimis exception or threshold amount of conflict minerals that must be present in a product. Even trace amounts of conflict minerals can trigger the application of the rule.

The materials content of a product is not always obvious from a visual inspection. As part of its determination, a company often will review materials content data forms, supplier declaration forms, engineering specifications, bills of material, and/or product part codes. Companies often will need to reach out to suppliers to determine whether there is 3TG content in the product components that they supply.

The SEC has indicated in an FAQ that packaging or containers used in the display, transport, or sale of a product are not considered part of the product. This is the case even if the packaging is necessary to preserve the product up to and following the product's purchase. However, packaging and containers are considered to be a product to the extent that the company manufactures and sells packaging or containers independent of the product that is ultimately included in the manufactured packaging or container.

Equipment and tools used to manufacture a product are not in-scope for purposes of the rule, even if the equipment or tools contain conflict minerals, since the conflict minerals must be included in the product itself to be in-scope.

Similarly, a conflict mineral that is a catalyst in the production process of a product is not in-scope if it is eliminated in its entirety during the production process.

**3. Manufacture and Contract to Manufacture.** The rule does not define what it means to manufacture a product. In the adopting release to the rule (collectively referred to as the "rule" in this article), the SEC indicates that it believes that the meaning of this term is generally understood.

The SEC has acknowledged that what it means to "contract to manufacture" a product is not always intuitive. It has provided guidance regarding the term's meaning, although the analysis is dependent on the facts and circumstances surrounding the company's business and industry. Whether a company has contracted to manufacture a product depends upon the degree of influence it exercised over the materials, parts, ingredients, or components included in the product. Simply having any influence over the manufacturing does not result in a company having contracted to manufacture a product. For example, the SEC has indicated that a mobile phone service provider that specifies to a third party manufacturer that phones must be able to function on a certain network has not exerted enough influence to be considered to have contracted to manufacture the phones. However, substantial influence is not required and it is not necessary for a company to specify the inclusion of a conflict mineral to have the requisite level of influence over the manufacturing of the product.

In the rule, the SEC indicates that a company has not contracted to manufacture a product if it did no more than:

1. specify or negotiate contractual terms with a manufacturer that do not directly relate to the manufacturing of the product, such as price, warranty, delivery, or indemnity terms;
2. affix its brand, mark, logo, or label to a generic product manufactured by a third party (including, as indicated in an FAQ, contracting to have one's logo etched on to a generic product); or
3. service, maintain, or repair a product manufactured by a third party.

Off-the-shelf components with conflict minerals content that are included in a higher-level product are considered to be in-scope for purposes of the rule. The application of the rule is not limited to the product components that the company manufactures or contracts to manufacture.

**4. Necessary to the Functionality or Production.** Even if a product contains conflict minerals, the minerals and the product will not be in-scope unless the conflict minerals are necessary to either the functionality or production of the product. This requires a facts and circumstances determination. According to the SEC, in making this determination, a company should consider:

1. Whether the conflict mineral is contained in or intentionally added to the product and is not a naturally occurring by-product;
2. Whether it is necessary to the product's generally expected function, use or purpose; and

3. If the mineral is incorporated for purposes of ornamentation, decoration, or embellishment, whether the primary purpose of the product is ornamentation or decoration.

## **Step 2: Conducting a Reasonable Country of Origin Inquiry and the Form SD Filing**

If, after completing its Step 1 inquiry, a company determines that a particular product is in-scope, it must proceed on to Step 2 with respect to that product and the in-scope conflict minerals contained in the product.

Step 2 requires a company to conduct a “reasonable country of origin inquiry” to determine whether the conflict minerals originated in the DRC or one of the other covered countries or are from recycled or scrap sources.

Recycled and scrap conflict minerals are treated differently under the rule because a company will not be able to trace their origin back as far as newly-mined minerals. 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. 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 conflict minerals. Minerals that are partially processed, unprocessed, or a by-product from another ore are not considered to be recycled.

The rule does not contain a bright-line standard for conducting the reasonable country of origin inquiry. What constitutes a reasonable inquiry for a particular company will depend upon various factors, such as the company’s size, its products, its relationship with suppliers, and its supply chain visibility at the time.

The inquiry must be reasonably designed to determine whether any of the company’s in-scope conflict minerals originated in a covered country or are from recycled or scrap sources. The rule also requires that the inquiry be performed in good faith. The inquiry does not require the company to establish with certainty the origin of the conflict minerals.

The reasonable country of origin inquiry may be satisfied by obtaining reasonably reliable representations indicating the facility at which the conflict minerals were processed and that demonstrate that the minerals did not originate in a covered country or that they came from recycled or scrap sources. These representations can come directly from the processing facility or from intermediate suppliers, but the company must have a reason to believe that the representations are true and correct given the circumstances surrounding them. A company is not necessarily required to receive representations covering all of its conflict minerals in order to make a country of origin determination, although the rule does not contain bright line guidance as to what constitutes an appropriate response level to support the determination.

A company can stop at Step 2 of the inquiry with respect to particular products and/or conflict minerals contained therein if:

1. It affirmatively determines that the conflict minerals originated outside the covered countries or came from recycled or scrap sources; or
2. Based on its reasonable country of origin inquiry, it has no reason to believe that the conflict minerals may have originated in a covered country or it reasonably believes that the conflict minerals are from recycled or scrap sources.

However, the company must file a Form SD that discloses its determination and briefly describes its reasonable country of origin inquiry. The company also is required to include the disclosure on its website and include a link to its website disclosure in the Form SD.

### Step 3: Due Diligence and the Conflict Minerals Report

The rule as adopted requires a company to conduct due diligence on the origin of conflict minerals and provide additional disclosure if, based on the company's reasonable country of origin inquiry, it knows that the conflict minerals originated in a covered country and were not from recycled or scrap sources, or if it has reason to believe that the conflict minerals may have originated in a covered country and that they may not be from recycled or scrap sources.

The rule requires Step 3 due diligence to be exercised in conformance with a nationally or internationally recognized due diligence framework. The only framework that satisfies this requirement is the framework developed by the Organisation for Economic Co-operation and Development (OECD). The OECD framework is contained in its Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (Guidance).<sup>[4]</sup> The OECD Guidance consists of the following five steps:

1. Establish strong company management systems;
2. Identify and assess risks in the supply chain;
3. Design and implement a strategy to respond to identified risks;
4. Carry out an independent third-party audit of supply chain diligence at identified points in the supply chain; and
5. Report on the supply chain due diligence.

More granular detail is contained in the Guidance and the related supplements, one of which covers tin, tantalum, and tungsten, and the other of which covers gold. As is the case with the rule, the application of the Guidance depends upon a company's particular facts and circumstances and presents many interpretive questions. The application of the Guidance also depends upon a company's particular location in the supply chain.

If, after its Step 3 due diligence, a company determines that its conflict minerals either (1) did not originate in a covered country or (2) came from recycled or scrap sources, it only must file a Form SD that indicates its determination and briefly describes its Step 2 reasonable country of origin inquiry and Step 3 due diligence efforts and the results of those efforts and otherwise satisfy the Form SD and website disclosure requirements applicable to the Step 2 inquiry.

If the company's Step 3 due diligence leads to any other conclusion, the rule as adopted requires it to prepare a conflict minerals report (CMR), as described below. As discussed below, the CMR requirement has been modified by subsequent developments.

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