

SEC Conflict Minerals Rule — The Debate Continues

Law360, New York (November 15, 2011, 12:13 PM ET) -- On Dec. 15, 2010, the U.S. [Securities and Exchange Commission](#) issued a proposed “conflict minerals” regulation that would require public companies to report to the SEC annually whether they use “conflict minerals” that originated in the Democratic Republic of Congo (DRC) or countries adjoining the DRC (collectively “DRC countries”).[1]

The term “conflict minerals” is defined to include cassiterite, columbite-tantalite, gold, wolframite, their derivatives or any other mineral or its derivatives determined by the secretary of state to be financing conflict in the DRC countries. These minerals are commonly used in electronics, such as cellphones, laptops and appliances, as well as in jewelry.

The proposed regulation has encountered strong opposition from a broad spectrum of industries. Eleven months have elapsed, and the regulators at the SEC are still struggling with the final rule. This article provides a brief review of the debate that has twice delayed the final conflict minerals regulation since its introduction in proposed form.

The Conflict Minerals Provision

Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act addresses trade in so-called “conflict minerals.” Section 1502 is a reflection of Congress’ effort to confront the humanitarian crisis in the DRC countries, based on the assumption that international trade in valuable minerals originating in the DRC countries fuels violence in the region.

Section 1502 amends the Securities Exchange Act of 1934 by adding new Section 13(p), which requires the SEC to promulgate a disclosure and reporting regulation for publicly traded companies that would require them to disclose annually whether any “conflict minerals” that are “necessary to the functionality or production” of a product manufactured by the company originated in the DRC countries.

The conflict minerals requirements potentially apply not only to publicly traded U.S. companies, but also extraterritorially to non-U.S. companies whose shares are listed on U.S. securities exchanges or whose American Depositary Receipts are traded on such exchanges.

The proposed regulation provides for a three-step disclosure procedure that would require reporting companies to disclose in their annual reports, based on their “reasonable country of origin inquiry,” whether any conflict minerals originated in the DRC countries.[2]

The requirement would apply to any issuer that files reports with the SEC and for whom conflict minerals are “necessary to the functionality or production of a product manufactured by such person.” Under the proposed regulation, if a company covered by the regulation concludes that its conflict minerals did not originate in the DRC countries, the company would disclose the determination and describe its “reasonable country of origin inquiry” process in its annual report.

If the company concludes that its conflict minerals did originate in the DRC countries or is unable to conclude that its conflict minerals did not originate in the DRC countries, the company would similarly disclose this conclusion, and in addition, provide the SEC with an audited conflict minerals report. Reporting companies would also be required to make the information available on their websites.

To comply with the new disclosure requirements, reporting companies would have to conduct due diligence on their supply chains and may need to adopt measures to improve their supply chain controls in order to track the use of conflict minerals. The SEC estimated that approximately 6,000 public companies, both manufacturers and retailers, would be affected by the new regulation. Certain private or foreign corporations that do not report to the SEC but operate in the supply chain of a publicly listed U.S. company, such as distributors, would also be affected because they likely would need to provide information and documentation to their customers.

The Debate

Since proposing the regulation last December, the SEC has postponed the final regulation twice because of a flood of comments and strong resistance from a wide array of industries. The latest effort by the SEC to finish its task was a meeting with interested companies and human rights activists on Oct. 18 to discuss the issues and concerns. At the center of the “conflict minerals” debate are the costs of complying with the new disclosure requirements.

The primary concerns are that the cost of conducting due diligence is too high and that achieving compliance is extremely difficult, if not impossible. While the SEC estimated it would cost companies about \$46 million to implement the reporting rule, industry groups came up with much larger costs. For example, the National Association of Manufacturers, a leading trading group opposing the new regulation, estimated the implementation costs to be between \$9 billion and \$16 billion.

At the Oct. 18 meeting with the SEC, industry representatives expressed the concern that it might be impossible for some companies to comply with the new disclosure requirements as proposed. For example, The [Boeing Company](#)’s representative said it is impossible for its manufacturers to identify all the mining sources for minerals that are present in millions of components from thousands of shifting suppliers. Boeing estimated that the requirements could cost the aerospace industry hundreds of millions, if not billions, of dollars, and the costs would be eventually passed on to customers, including the U.S. Department of Defense.[3]

[General Electric Co.](#)’s representative expressed similar concerns and stated that it would be impossible for GE to comply with the requirements for now and that the SEC should offer more flexibility to companies, such as statistical sampling.[4] Also present at the meeting was a representative from [Kraft Foods Inc.](#), which reportedly would be subject to the disclosure requirements because the company’s food packages contain tin. The representative noted that Kraft uses 100,000 suppliers to make 40,000 products and that the task of compliance is overwhelming.[5]

In addition to the concerns over the practicality and costs of achieving compliance, many questions have arisen as to the interpretation and the scope of the regulation, such as:

- the definition of “conflict minerals” — i.e., the types of minerals and derivatives that should be covered by the rules;
- the interpretation of “necessary to the functionality or production” of a product (the proposal lacks guidance on the meaning of this key term);
- whether there should be a de minimis exception (the proposed regulation does not have one); and
- the standard for evaluating whether a country of origin inquiry is “reasonable” (the proposed regulation does not explain what constitute a “reasonable” country of origin inquiry).

Supporters of strict regulations on conflict minerals include human rights activists and some leading consumer electronics companies, such as [Apple Inc.](#) and [Intel Corp.](#). Apple has reportedly implemented a conflict minerals tracking mechanism in advance of the rules.

Some advocates have argued that implementing a compliance program would benefit companies by improving the overall control of the supply chain. In addition, some activist groups, most notably the Enough Project and Global Witness, argue that the international demand for electronic products that require minerals from the DRC is driving the deadly conflict in the DRC. These organizations have been pushing for strict conflict minerals reporting regulations.

Conclusion

While the SEC is hoping to finalize the new regulation by the end of 2011, it likely will defer the deadline again, given the feedback at the Oct. 18 roundtable. The SEC may have to perform a new cost-benefit analysis in light of the big disparity between its cost calculations and those of industry groups, especially since another SEC rule was invalidated by the D.C. Circuit earlier this year because of the SEC’s failure to conduct a proper cost-benefit analysis. Even at this late stage,

concerned companies may wish to make their views known to the SEC.

Once the SEC adopts the final regulation, reporting companies would need to provide the initial conflict minerals disclosure or report after their first full fiscal year following the promulgation of the final regulation. Despite the prospect of further delay, and considering the complexity of tracing the source of potential conflict minerals, public companies and their suppliers should act, sooner rather than later, to identify and assess risk in the supply chain and to develop a strategy to respond to the new disclosure requirements.

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[1] See 75 Fed. Reg. 80,948 (Dec. 23, 2010). “Adjoining countries” are defined as countries that share a border with the DRC and include Angola, Burundi, the Central African Republic, the Republic of the Congo, Rwanda, Sudan, Tanzania, Uganda and Zambia.

[2] For more detailed information on the requirements of the proposed conflict minerals regulation, see Alston & Bird’s Dec. 16, 2010, advisory, available at <http://www.alston.com/files/Publication/ed794172-81ef-4c42-9310-48689cb3aab8/Presentation/PublicationAttachment/ff53d454-d0bc-4b8a-b9f3-4dd5b4116391/Conflict%20Minerals%20Advisory.pdf>.

[3] See David S. Hilzenrath, “SEC struggles to write ‘conflict minerals’ regulations for companies,” The [Washington Post](#) (Oct. 18, 2011), available at http://www.washingtonpost.com/business/economy/sec-struggles-to-write-conflict-minerals-regulations-for-companies/2011/10/18/gIQAvZqfvL_story.html (last visited on Oct. 24, 2011).

[4] See id.

[5] See id.

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