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Conflict minerals: Dodd-Frank turns a light on the DRC

New rules have been adopted in the US requiring annual disclosures of the use in manufacturing of 'conflict minerals' sourced from and around the Democratic Republic of the Congo. The rules will bite from 2013 giving affected organisations only a few months to finalise their preparations.

Summary

On 22 August 2012 the Securities and Exchange Commission (SEC) of the United States adopted final rules under section 1502 of the Dodd-Frank Act governing mandatory annual disclosures of the use of so-called "conflict minerals" extracted from the Democratic Republic of the Congo (DRC) and adjoining countries.

Conflict minerals as defined include columbite-tantalite (coltan), cassiterite, gold, wolframite and their derivatives tantalum, tin and tungsten, regardless of the country of their origin. The US Secretary of State may in future include further minerals or derivatives in this definition. Given the use of conflict minerals in a wide range of products, the rules will impact up and down supply chains across a number of sectors, particularly the aerospace, automotive, consumer packaging, defence, electronics and communications, jewellery and technology sectors.

Who will be affected?

The rules apply to each company (whether US or not) that both (a) files reports with the SEC under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (b) uses conflict minerals that are necessary to the functionality or production of a product manufactured or contracted by it to be manufactured. Neither Dodd-Frank nor the new rules define the key phrases "necessary to functionality or production", "manufactured" or "contracted...to be manufactured". The SEC's release adopting its final rules[1] does however provide some guidance on their interpretation. The SEC has for instance indicated that a company will not have contracted to manufacture a product where it merely sells under its own brand a generic product manufactured by a third party[2]. Importantly, the SEC has also indicated that it does not consider that mining constitutes "manufacturing" and thus that companies that mine or contract to mine conflict minerals would not be subject to the rules unless they also engaged in manufacturing[3].

Key issues

- Rules require annual disclosures to the SEC of the use of "conflict minerals" in products
- Conflict minerals are used across a number of sectors
- Manufacturers are directly affected, suppliers and extractors indirectly affected
- The first disclosures will relate to the year starting 1 January 2013

Although manufacturing industries will be directly subject to the new rules, it is important to note that there will inevitably be a spreading of the indirect burden of the rules all the way down supply chains as those subject to the rules seek to comply with them. A wide range of suppliers and processers of conflict minerals will therefore be impacted. The SEC has estimated that 5,994 companies will be subject to the rules, while some respondents to the SEC's proposing release estimated the total number

1 Available at www.sec.gov/rules/final/2012/34-67716.pdf.
2 Securities and Exchange Commission Release No. 34-67716, Section II.B.2.c.ii.
3 Securities and Exchange Commission Release No. 34-67716, Section II.B.3.c.

affected could run into the hundreds of thousands[4].

How will companies comply?

Compliance with the rules centres around the annual submission to the SEC of a special disclosure report on the new Form SD, the contents of which will depend on the outcome of enquiries required to be made by the rules.

If a company determines that it is subject to the rules under the criteria set out above, it will be required to carry out a "reasonable country of origin enquiry" regarding the relevant conflict minerals to determine whether any of them either originated in the DRC or an adjoining country, or are from recycled or scrap sources. A company's burden of compliance will depend on the outcome of its enquiry.

A lower burden of compliance will be imposed if either (a) the enquiry concludes that the minerals did not originate in the DRC or an adjoining country; (b) the enquiry concludes (or on the basis of the enquiry the company reasonably believes) that the minerals came from recycled or scrap sources; or (c) based on the enquiry the company has no reason to believe that they may have originated in the DRC or an adjoining country. In such case a company will only be required to disclose its determination on the Form SD, together with a description of the enquiry and its results, and to make the same information available on its website.

However, a higher burden will be imposed if following its initial enquiry the company either (a) knows that the minerals originated in the DRC or an adjoining country and are not from recycled or scrap sources; or (b) has reason to believe that the minerals may have originated in the DRC or are not from recycled or scrap sources. In such a case the company must exercise "due diligence" on the source and chain of custody of the relevant conflict mineral that conforms to a nationally or internationally recognised due diligence framework (where available). Depending on the outcome of the due diligence, the company may be required only to make disclosures on the Form SD and its website similar to those described in the paragraph above, or may be required to submit together with the Form SD a more comprehensive "Conflicts Minerals Report".

The level of detail required in each Conflicts Minerals Report will depend on the outcome of the company's due diligence exercise and its conclusion on whether its products are "DRC Conflict Free" (i.e. not financing armed groups) or "Not DRC Conflict Free". For a two-year transitional period a company may also state that its products, to the extent accurate, are "DRC Conflict undeterminable." An independent private sector audit of the Conflict Minerals Report may also be required. Broadly, an audit will be required except where the products are determined either to be "DRC conflict undeterminable" (although as described above this exemption is temporary) or made from recycled or scrap gold (currently, a private audit is not required for Conflict Mineral Reports related to products manufactured from other recycled or scrap conflict minerals).

When do the rules come into force?

As above, companies subject to the rules will be required to submit Forms SD (and any appended reports) annually. Reporting will be on a calendar year basis, regardless of a company's financial year, with documents to be filed with the SEC no later than 31 May after the end of the year being reported on. The first reports under the rules will thus be due to be submitted by 31 May 2014 in respect of the year from 1 January 2013 to 31 December 2013.

Why does it matter?

The rules fit into a context of a generally increasing focus on corporate social responsibility issues by governments, investors and the general public and come at a time of increasing disclosure requirements linked to resource extraction. The SEC adopted the rules concurrently with its final rules on the disclosure of payments by resource extraction issuers and come only a short time after the European Commission published its proposed rules on payment disclosures by natural resources undertakings[5]. However despite forming part of a generally increasing and accepted focus on corporate responsibility issues the rules have not been without controversy, not least due to the delay of their implementation.

[4] Securities and Exchange Commission, Release No. 34-63547, Section III.B.2.b.

[5] For a discussion of the European Commission's proposed new rules see our July 2012 Briefing "Disclosure requirements for natural resource companies: baring all in Europe".

The adoption of the rules has taken place over a year from the deadline for adoption set out in section 1502 of Dodd-Frank and over two years from the signing of the act into law on 21 July 2010. Given uncertainties surrounding the rules in the interim, preparation for their implementation has so far been difficult. It is suspected in the market that some organisations have taken a precautionary approach and reduced their investment in mining in affected countries.

It is anticipated that the impact of the rules on industries up and down supply chains across those sectors reliant on conflict minerals will be substantial. Affected organisations will need to ensure that they accurately establish and record the provenance of the conflict minerals they use. To do this effectively they will need to ensure that their suppliers and all those in their supply chain down to the relevant mineral extractors do the same.

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