

SEC's Forthcoming Conflict Mineral Rules Form Part of Emerging Regulatory Landscape

The US Securities and Exchange Commission (SEC) recently reiterated its commitment to finalize new rules mandating disclosure of due diligence with respect to “conflict minerals” from Central Africa. The rules, issued in draft form in December 2010, are required under a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Although the SEC missed its April 2011 statutory deadline to promulgate implementing rules, it now says it will finalize them by December 2011.

Parallel to the SEC's rulemaking process, the Organisation for Economic Co-operation and Development (OECD), with 34 member nations including the United States and many other industrialized nations, has issued due diligence guidance regarding mineral sourcing. The European Union and other nations are actively considering conflict mineral regulations of their own and are therefore following the SEC's progress closely. In addition, California recently enacted a law prohibiting its state agencies from contracting with any company that fails to comply with the SEC's forthcoming regulations. The sustained interest in conflict mineral regulation in multiple parts of the world suggests that the release of the SEC's final rules may usher in a proliferation of related initiatives. If so, the SEC's new rules will not be the only standards by which the private sector's due diligence in this area is judged.

This Advisory explains Dodd-Frank's conflict mineral provision, the SEC's difficulty in implementing that provision, the OECD's related due diligence guidelines, and the prospect of regulatory activity on multiple new fronts.

Dodd-Frank Section 1502: The US Conflict Mineral Provision

Section 1502 of Dodd-Frank required the SEC, in consultation with the US Department of State, to devise a reporting requirement by April 15, 2011, on the measures companies required to file reports with the SEC have taken to exercise due diligence on the source and chain of custody of four minerals: tantalum, tin, tungsten, and gold.¹ These minerals are referred to as “conflict minerals” because they are sometimes exploited to finance armed conflict in the Democratic Republic of Congo (DRC) and surrounding areas. Manufacturers of electronics, such as mobile phones, digital cameras, and computers, and companies in the automotive, construction, medical equipment, and aerospace sectors utilize large

¹ Dodd-Frank, Pub. L. No. 111-203, § 1502 (2010).

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quantities of the four minerals.² The SEC has estimated that over 5,000 companies will be subject to the new corporate social responsibility requirement.³

The SEC issued detailed proposed rules on December 15, 2010.⁴ Under the draft rules, Dodd-Frank's reporting requirement applies to any company filing annual reports with the SEC that manufactures (or contracts for the manufacture) a product for which conflict minerals are necessary to the functionality or production of that product.⁵ Any such company must disclose in its annual report to the SEC whether its conflict minerals originated in the DRC or an adjoining country. If the covered company's minerals originated in the DRC or an adjoining country, it must draft and submit to the SEC a Conflict Minerals Report, including an independent private sector audit of its supply chain, as an exhibit to its annual report and on its website.

The SEC's proposed rules included a number of questions to the public, including whether and how to define terms such as "manufacture" and "necessary to the functionality or production of a product," and whether it should exclude certain companies or set a minimum threshold for the level of influence or control over a manufacturing process before obligating a company to comply with the rules.

Delay in the Release of the SEC's Final Rules

The SEC failed to issue final regulations prior to Dodd-Frank's deadline of April 15, 2011. The rules' postponement has dismayed advocates of the reporting requirement. On September 23, 2011, for example, Representative Barney Frank (D - Mass.) and five Democratic colleagues sent a letter to SEC Chairman Mary Schapiro calling for vigorous implementation of Section 1502 without further delay.⁶ A

week later, the SEC announced that it would host an October 18, 2011 public forum on issues related to its conflict mineral rulemaking, focusing on "appropriate reporting approaches for the final rule, challenges in tracking conflict minerals through the supply chain, and workable due diligence and other requirements related to the rulemaking."⁷ In the announcement, SEC Division of Corporate Finance Director Meredith Cross pledged that the SEC is "committed to writing a rule as soon as possible."⁸

The agency has told the public that it will issue final rules in the "August - December 2011" period.⁹ As many corporations will commence a new fiscal year on January 1, 2012, the final rules' delay until late this year may make it difficult for them to establish an appropriate due diligence infrastructure before the compliance period begins.

There are several possible explanations for the SEC's difficulty in finalizing the rules. Dodd-Frank generally assigned the SEC a heavy load, with rulemaking responsibility in dozens of areas. Section 1502's implementation is complex because it is broadly worded, potentially very burdensome, and silent on the resolution of important issues. Furthermore, it is an unusual provision for the SEC to implement. Section 1502 is fundamentally designed to address humanitarian matters (as opposed to economic matters or investor protection). The SEC is developing its rules in consultation with the State Department and is hearing from parties not usually involved in the SEC rulemaking process, such as human rights advocacy organizations. It has even received views from the Democratic Republic of the Congo itself.¹⁰ In addition, recent editorials in the *New York Times* and *Christian Science Monitor* have attacked the reporting requirement as counterproductive and raised concerns

² A prior Arnold & Porter LLP Advisory provides an in-depth assessment of the SEC's proposed rules. See http://www.arnoldporter.com/public_document.cfm?id=17106&key=5G2.

³ Conflict Minerals, Release No. 34-63547 (Dec. 15, 2010), 75 F.R. 80948, 80966-67 (Dec. 23, 2010).

⁴ *Id.* at 80948.

⁵ The SEC's proposed rules would apply to any issuer that meets these requirements and files reports with the SEC under Sections 13(a) or 15(d) of the Exchange Act. *Id.* at 80950-51.

⁶ Letter from Honorable Howard L. Berman et al., Members of Congress, to Mary Schapiro, SEC Chairman (Sept. 23, 2011), available at <http://www.sec.gov/comments/s7-40-10/s74010-313.pdf>.

⁷ US Securities and Exchange Commission, *SEC to Hold Roundtable on Conflict Minerals* (Sept. 29, 2011), available at <http://www.sec.gov/news/press/2011/2011-197.htm>.

⁸ See *id.*

⁹ US Securities and Exchange Commission, *Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act — Upcoming Activity*, available at <http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml> (last visited Oct. 10, 2011).

¹⁰ Letter from Martin Kabwelulu, Minister of Mines, Democratic Republic of Congo, to Mary Schapiro, SEC Chairman (July 15, 2011), available at <http://www.sec.gov/comments/s7-40-10/s74010-277.pdf>.

about its effective implementation, which may have led to further discussions within the US government.¹¹ Moreover, the SEC may be treading carefully given a DC Circuit Court of Appeals decision overturning a proxy access rule because the SEC had not adequately analyzed its effects on efficiency, competition, and capital formation, and the very real possibility that some issuers may challenge the new rules in court after they are issued.¹²

Regardless of how the SEC resolves some of the difficult definitional and scope issues before it, the final rules are certain to be burdensome for covered companies using the relevant minerals. Companies currently have no requirements of public disclosure of due diligence in this area. While there has been substantial debate about how the rules ultimately should be drafted, it is likely that the final rules will in many key respects simply track the very broad new disclosure requirements of the statute. Thus, entities that believe they will be covered under the new law should at the same time begin to review and evaluate relevant policies, practices, and record-keeping, to ensure that they will be able to comply with the new requirements.

A Parallel International Process on Conflict Minerals: The OECD Guidance

Contemporaneous with the SEC's rulemaking process, the OECD, an international organization based in Paris with member nations from most of the world's most developed economies,¹³ has hosted an international dialogue on strategies to mitigate risk that mineral purchases contribute

to armed conflict in the DRC region. Talks among OECD members and industry, civil society, and a number of nations from Africa, from December 2009 to September 2010, led to the OECD's issuance of "Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas" (OECD Guidance).¹⁴

The OECD Guidance includes detailed recommendations for due diligence, based in a five-step progressive due diligence framework:

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

In a separate forum, the United Nations Group of Experts on the Democratic Republic of the Congo, a group established by the UN Security Council,¹⁵ endorsed the OECD's framework and utilized it as the basis for its own recommendations for importers, processors, and consumers on avoiding support for illegal armed groups, criminal networks, and perpetrators of serious human rights abuses.¹⁶ Even more significantly, in November 2010, the UN

11 See David Aronson, *How Congress Devastated Congo*, NY Times, Aug. 7, 2011, available at <http://www.nytimes.com/2011/08/08/opinion/how-congress-devastated-congo.html>; Jason Stearns, Opinion: US Policy on Congo Conflict Minerals Well-Intentioned, But Misguided, Christian Science Monitor, Aug. 4, 2011, available at <http://www.csmonitor.com/World/Africa/Africa-Monitor/2011/0804/Opinion-US-policy-on-Congo-conflict-minerals-well-intentioned-but-misguided>.

12 See *Bus. Roundtable v. S.E.C.*, 647 F.3d 1144, 1148-49 (D.C. Cir. 2011) (vacating Exchange Act Rule 14a-11 governing shareholder access to the proxy process of nominating and electing a corporation's board of directors).

13 OECD members include, for example, the United States, Canada, Mexico, the United Kingdom, France, Germany, Austria, Italy, Australia, New Zealand, Japan, South Korea, Israel, Turkey, and Chile.

14 OECD, *Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas of the Organization for Economic Cooperation and Development* (2011) (OECD Guidance), available at <http://www.oecd.org/dataoecd/62/30/46740847.pdf>.

15 The Group of Experts was originally established by the UN Security Council in resolution 1533 in 2004. The Security Council has repeatedly renewed the Group's mandate. See Security Council Committee established pursuant to resolution 1533 (2004) concerning the Democratic Republic of the Congo, available at <http://www.un.org/sc/committees/1533/> (last visited Oct. 10, 2011).

16 Letter dated 15 November 2010 from the Chair of the Security Council Committee established pursuant to resolution 1533 (2004) concerning the Democratic Republic of the Congo addressed to the President of the Security Council, ¶¶ 303-69, U.N. Doc S/2010/596 (Nov. 29, 2010), available at <http://www.un.org/Docs/journal/asp/ws.asp?m=S/2010/596>.

Security Council passed Resolution 1952, which expressed its unanimous support for these recommendations and the underlying five-step due diligence framework.¹⁷

The United States is a leader in both the OECD and the UN and has supported each body's efforts to promote responsible mineral sourcing. The SEC's draft rules did not specify a standard for "reasonable" due diligence, which the SEC explained was "because the conduct undertaken by a reasonably prudent person may vary and evolve over time."¹⁸ However, following the release of the SEC's draft rules, two senior US Department of State officials called on the SEC to harmonize its final rules with the OECD Guidance.¹⁹ The State Department, which has a statutory consultative role in the SEC's conflict mineral rulemaking, subsequently issued a formal statement endorsing the OECD Guidance.²⁰

The OECD Ministerial Council, which is composed of the economic ministers from each of its 34 member nations, agreed on a recommendation that members should "actively promote" observance of its Guidance by companies operating in or from their territories at its May 25, 2011 meeting.²¹ In the meantime, the OECD has continued direct engagement with multinational companies by initiating a pilot program, which may result in revisions to its Guidance. The July 2011 to June 2012 test-run has enlisted the participation

of major multinational corporations such as Nokia and Panasonic.²²

Additional Regulatory Activity is Likely to Follow the Publication of the SEC's Final Rules

The OECD's recommendation that its members "actively promote" compliance with its Guidance as well as international attention on this subject may lead many other countries to devise national legislation on the topic, some but not all of which might be similar to the SEC rules that are ultimately adopted. In that regard, in its letter to the SEC the US Department of State has endorsed the OECD Guidance and "urged governments to take steps that support" the OECD framework.²³ Once the SEC completes its work, companies may see a raft of national legislation, guidance, recommendations, oversight requirements, etc., touching on conflict mineral-related disclosures. To the extent these requirements are inconsistent with the SEC rules or each other, covered companies will have significant challenges determining what kind of compliance program to develop.

In this connection, on October 7, 2010, the EU Parliament passed a resolution that welcomed the adoption of the new US Conflict Minerals Law and asked the European Commission and Council "to examine a legislative initiative along these lines."²⁴ The Commission responded by stating

17 S.C. Res. 1952, ¶¶ 7-8, U.N. Doc. S/RES/1952 (Nov. 29, 2010), available at <http://daccess-ods.un.org/TMP/1517312.37769127.html>.

18 Conflict Minerals, Release No. 34-63547 (Dec. 15, 2010), 75 F.R. 80948, 80961 (Dec. 23, 2010).

19 Letter from Under Secretary of State for Economic, Energy and Agricultural Affairs Robert D. Hormats and Under Secretary of State for Democracy and Global Affairs Maria Otero to the Securities and Exchange Commission (Jan. 24, 2011), available at <http://www.sec.gov/comments/s7-40-10/s74010-42.pdf>; Letter from Under Secretaries of State Hormats and Otero (Mar. 24, 2011), available at <http://www.sec.gov/comments/s7-40-10/s74010-201.pdf>.

20 US Department of State Bureau of Economic, Energy, and Business Affairs, Statement Concerning Implementation of Section 1502 of the Dodd-Frank Legislation Concerning Conflict Minerals Due Diligence (July 15, 2011), available at <http://www.state.gov/e/eeb/diamonds/docs/168632.htm>.

21 OECD Guidance at 8-9. Eight non-OECD countries also joined in adopting this recommendation: Argentina, Brazil, Egypt, Latvia, Lithuania, Morocco, Peru, and Romania. OECD, *New OECD Guidelines to Protect Human Rights and Social Development* (May 25, 2011), available at [New OECD guidelines](#).

22 *Nokia Welcomes Recent Developments to Fight Conflict Minerals*, Nokia Conversations (Sept. 23, 2011), available at <http://conversations.nokia.com/2011/09/23/nokia-welcomes-recent-developments-to-fight-conflict-minerals/>; *Panasonic to Implement OECD Due Diligence Guidance to Ensure Conflict-Free Procurement*, MarketWatch (Sept. 30, 2011), available at <http://www.marketwatch.com/story/panasonic-to-implement-oecd-due-diligence-guidance-to-ensure-conflict-free-procurement-2011-09-30>.

23 US Department of State Bureau of Economic, Energy, and Business Affairs, Statement Concerning Implementation of Section 1502 of the Dodd-Frank Legislation Concerning Conflict Minerals Due Diligence (July 15, 2011), available at <http://www.state.gov/e/eeb/diamonds/docs/168632.htm>.

24 European Parliament, Texts Adopted (European Parliament resolution of 7 October 2010 on failures in protection of human rights and justice in the Democratic Republic of Congo), ¶ 14 (Oct. 7, 2010), available at <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2010-0350&language=EN>; see also European Parliament, Texts Adopted (European Parliament resolution of 15 December 2010 on the future of the EU-Africa strategic partnership following the 3rd EU-Africa Summit), ¶ 8 (Dec. 15, 2010), available at <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2010-0482+0+DOC+XML+V0//EN&language=EN>. ("[The Parliament]

it “has noted” the SEC’s proposed rules and that “[f]urther analysis should be conducted on the impact of this policy since the process of identifying the supply chain of minerals is very complex.”²⁵ The continued interest in this topic among EU members of Parliament and broadly among OECD member nations suggests that the release of the SEC’s final rules will trigger other activity in the conflict mineral arena.

The prospect of regulation even extends to individual states of the United States. On September 9, 2011, the California legislature passed Senate Bill 861, which will prohibit state agencies from contracting with any company that fails to comply with the SEC’s upcoming diligence and disclosure requirement. Barring an unexpected 11th-hour veto by California Governor Jerry Brown, the bill will become law on October 16, 2011. California’s contracting restriction will be triggered when the SEC brings a successful enforcement action against a covered company for violating the final conflict mineral rules.²⁶ Any such violator will be ineligible to submit a contract proposal to California state agencies for three years, or until the company comes into compliance.

Because the California law’s penalty only applies after the SEC brings a successful enforcement action, the state’s move for now is chiefly symbolic. That said, the new measure is a clear indication that the SEC’s regulations are being watched by state governments. Other US jurisdictions are also beginning to get involved. The St. Petersburg, Florida city council recently passed a resolution calling on the city to “favor verifiably conflict-free products” in its purchases.²⁷ Pittsburgh passed a

proclamation earlier this year urging “electronic companies and other industries to take the necessary steps to remove conflict minerals from their supply chain.”²⁸

The sustained interest in conflict mineral regulation in the United States and internationally reflects that the SEC’s rules are a part of a potentially complex new regulatory environment. Once the SEC’s rules are finalized, other jurisdictions are likely to follow with rules of their own. Despite the possibility that the SEC’s rules may be taken as a potential benchmark for EU regulation, the EU and other governing bodies may ultimately adopt conflicting approaches. For instance, countries may adopt the substantive due diligence of the OECD Guidance rather than choosing to leave the appropriate standard of due diligence open-ended, as the SEC draft rules have done. Regardless of how the various jurisdictions decide to promulgate rules, covered companies around the world are likely to be subjected to challenging new oversight and responsibilities.

²⁸ City of Pittsburgh, Proclamation 2011-1639 (Apr. 19, 2011), available at <http://pittsburgh.legistar.com/LegislationDetail.aspx?ID=873982&GUID=53DB676C-7643-4948-A56D-6731D4925634>.

[c]onsiders that the adoption of the new US ‘Conflict Minerals’ law is a huge step forward in combating illegal exploitation of minerals in Africa, which fuel civil wars and conflicts; is of the view that the Commission and the Council should come out with similar proposals to ensure tractability of imported minerals in the EU market while taking into account the Extractive Industries Transparency Initiative (EITI).”

²⁵ European Parliament, Parliamentary Questions (Answer Given by Mr. Barnier on Behalf of the Commission) (June 9, 2011), available at <http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=P-2011-004340&language=EN>.

²⁶ California Senate Bill No. 861, available at http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_0851-0900/sb_861_bill_20110913_enrolled.pdf.

²⁷ Tampa Bay Business Journal, *St. Pete Passes Resolution on Congo Conflict-Free Minerals* (Oct. 4, 2011), <http://www.bizjournals.com/tampabay/news/2011/10/04/st-pete-passes-resolution-on-congo.html>.

We hope that you have found this advisory useful. If you have any questions, please contact your Arnold & Porter attorney or:

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