SQUIRE SANDERS

CONFLICT MINERALS RULE UPDATE

April 2014

Court of Appeals Decision

Shortly after it was issued, several trade associations filed a legal challenge to the US Securities and Exchange Commission's (SEC) Conflict Minerals Rule. The trade associations challenged the SECs cost-benefit analysis, questioned many of the SECs discretionary choices and claimed that certain requirements of the Conflict Minerals Rule violate the First Amendment.

On April 14, 2014, in a 2-1 decision, the District of Columbia Court of Appeals sided with the SEC and rejected all but one of the trade associations' arguments. After discussing the legal test for its review of the First Amendment claim, the court concluded that portions of Section 1502 of the Dodd-Frank Act and of the SECs Conflict Minerals Rule violated the First Amendment when they required that reporting companies report to the SEC and state on their websites that any of their products have "not been found to be 'DRC conflict free.'" The court remanded the case to the district court for further proceedings.

It was the product description requirement that was the focus of the court's attention. In what will likely be the most quoted selection from the opinion, the majority stated "The label 'conflict free' is a metaphor that conveys moral responsibility for the Congo war.…By compelling an issuer to confess blood on its hands, the statute interferes with that exercise of the freedom of speech under the First Amendment."

However, despite the decision by the Court of Appeals, uncertainty remains. The court did not stay the implementation of the Conflict Minerals Rule, and all provisions other than the "not found to be 'DRC conflict free'" product description and public posting of that description remain valid. Within the next couple of weeks, any of a number of actions might clarify the implications of the court's decision – the trade associations could seek a stay of the implementation of the Conflict Minerals Rule in order to delay any required filings beyond the current June 2, 2014 filing deadline, the SEC could challenge the Court of Appeals' decision, and/or the SEC might communicate that it expects reporting companies to file the required disclosure except for the "not been found to be 'DRC conflict free'" product description.

Until the implications of the Court of Appeals decision are known, companies should continue to press forward with their inquiries, diligence and with the drafting of their Form SDs and Conflict Minerals Reports so that they are prepared to make the conflict minerals disclosures by the June 2, 2014 deadline.

Additional FAQs from the SEC

On April 7, 2014, the SECs Division of Corporate Finance provided a second set of FAQs relating to the disclosure regarding the use of conflict minerals from the Democratic Republic of the Congo or adjoining countries (Covered Countries). Of the nine additional FAQs, most provide clarification about the Independent Private Sector Audit (IPSA). Based on these clarifications, the number of reporting companies that will be required to obtain an IPSA in this first year of reporting is fewer than originally believed. In addition, the effect of the guidance provided in several other FAQs is that it will be difficult for a company to claim in these first reports that any of its products is conflict-free.

In particular, the FAQs do not address any of the difficult issues of interpretation that companies are struggling with as they consider whether the Conflict Minerals Rule applies to them, and as they analyze their suppliers' responses and prepare their filings. And it is clear that no guidance will be provided on these vexing issues before the June 2, 2014 filing deadline. So reporting companies will be left to exercise their best legal judgments on how to deal with these unanswered questions.

A complete set of the SEC's FAQs is provided. We described the first set of FAQs, issued in May 2013, in Additional Guidance Via FAQs From The SEC. The second set of FAQs (numbers 13-21) is summarized below.

Insights Relating to the Independent Private Sector Audit (IPSA)

- An auditor who is not a certified public accountant is permitted to perform the IPSA. (FAQ 13)
- If any of the reporting company's products are "DRC conflict undeterminable," an IPSA is not required. (FAQ 14) Remember, it is only possible to claim that a product is "DRC conflict undeterminable" after conducting due diligence about the source and chain of custody of the necessary conflict minerals contained in that product. While reporting companies with necessary conflict minerals from a Covered Country in their products will be required to conduct due diligence, most are likely to claim that at least one product is "DRC conflict undeterminable," which means that an IPSA would not be required. Other than confirming that an IPSA is not required if any products are "DRC conflict undeterminable," this clarification does not change the substance of what must be reported in the Conflict Minerals Report.
- If a reporting company describes any products as "DRC conflict undeterminable" and, therefore, does not perform an IPSA, it cannot describe other products as "DRC conflict free." To be able to describe a product as "conflict free," the company must have obtained an IPSA. (FAQ 15) Those companies that would like to claim that a product is "conflict free" but have any products that are "DRC conflict undeterminable" will not be able to claim any products are conflict free unless they do obtain an IPSA.
- The IPSA has two distinct (and not overlapping) objectives: (1) to express whether the design of the due diligence measures conform, in all material respects, with the criteria of the nationally or internationally recognized framework (which is currently the OECD Guidelines), and (2) to express whether the description of the due diligence measures performed is consistent with the process the reporting company actually undertook. It is clear that the IPSA is not intended to comment on the reasonableness or completeness of the due diligence conducted by the reporting company. (FAQ 17)

- The IPSA is not required to opine on the reasonable country of origin inquiry (RCOI). (FAQ 18). The Conflict Minerals Rule makes it clear that the RCOI and the due diligence are separate processes with different sets of requirements. The RCOI is part of step 2 of the Conflict Minerals Rule and, if undertaken, is required to be described in the Form SD. The due diligence is required by step 3 of the Conflict Minerals Rule and must be described in the Conflict Minerals Report. While it is true that many of the steps are the same and the RCOI and the due diligence may overlap, only the due diligence is subject to the IPSA. Technically, due diligence is the measures taken by the reporting company after it determines that its necessary conflict minerals originated from or may have originated from a Covered Country.
- The reporting company's due diligence measures must be described in sufficient detail in the Conflict Minerals Report to allow the auditor to form an opinion as to whether the description of the due diligence is consistent with the measures that the reporting company actually performed. However, the design of the due diligence need not be described in full in the Conflict Minerals Report. (FAQ 21)

Insights Relating to Various Classifications of Conflict Minerals in One Product

- A product cannot be described as "conflict free" if it contains any conflict minerals whose source was not determined or if it was not possible to determine that the conflict mineral did not benefit or finance an armed group. Importantly, if a product contains a conflict mineral that did benefit or finance an armed group, it must be described as "having not been found to be 'DRC conflict free.'" (FAQ 16)

Insights Relating to Recycled or Scrap Sources

- If a product contains some conflict minerals from recycled or scrap sources and some that are not from recycled or scrap, the disclosure about the RCOI and how the reporting company determined that the conflict minerals were from recycled or scrap sources must be described on the Form SD. The description of the due diligence and other required disclosure about the conflict minerals that were not from recycled or scrap sources must be reported in the Conflict Minerals Report. (FAQ 19)

Insights Relating to Due Diligence

- Due diligence measures need not necessarily be carried out throughout the entire year covered by the Conflict Minerals Report. And the due diligence measures carried out for a calendar year may begin before or extend beyond that calendar year. (FAQ 20)

As the June 2 reporting deadline approaches, you can call on Squire Sanders' Conflict Minerals team for experienced, practical guidance on your Conflict Minerals compliance needs. If you have any questions or concerns regarding disclosure, please contact your usual Squire Sanders lawyer or one of the individuals listed in this publication.

Contacts

Dynda A. Thomas
+1 216 479 8583
dynda.thomas@squiresanders.com

Andrew J. Renacci
+1 216 479 8501
andrew.renacci@squiresanders.com

12876/04/14