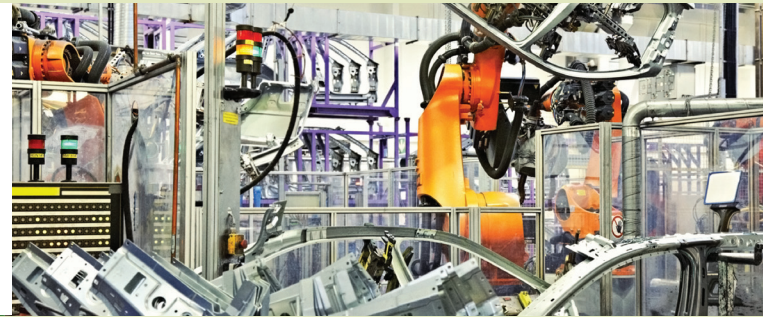
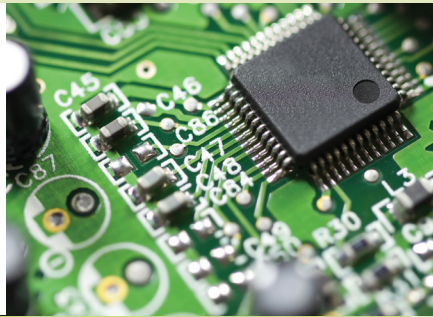


Conflict Minerals Compliance: Observations and Recommendations for 2014 and Beyond

A White Paper by Michael R. Littenberg
and Farzad F. Damania



The Conflict Minerals Rule was adopted during August 2012 and took effect at the beginning of 2013. Since then, many companies have made significant progress in addressing the requirements of this complex rule, moving from determining applicability through establishing a compliance team, developing compliance procedures and engaging in product filtering and vendor outreach. Some companies are even fairly far along in validating vendor responses and have prepared initial drafts of their Form SD and accompanying Conflict Minerals Report. However, to paraphrase Winston Churchill, most companies are not at the end or even at the beginning of the end of the compliance process. Rather, they are approaching the end of the beginning. With that in mind, we offer the following observations and recommended action items for consideration.

Compliance Is About More Than Just Data Gathering and Reporting

Under the Rule, if a company is required to conduct due diligence, it generally must do so in conformity with a nationally or internationally recognized due diligence framework. The only framework that currently satisfies this requirement is the [Organisation for Economic Co-operation and Development's Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas](#). Depending upon level of granularity, this five-step framework, including supplements, contains approximately 40 different discrete compliance procedures for downstream companies to consider, implement and document.

Expect NGOs, socially responsible investors and other responsible sourcing constituencies to focus on the due diligence measures that are described in your Conflict Minerals Report, including whether these measures conform to the Guidance. In addition, public and private supply chain intermediaries need to be mindful of contractual requirements, customer policies and vendor codes of conduct that require them to implement due diligence procedures that are consistent with the Guidance. Also expect some, albeit a small number, of customers to spot-check vendor compliance programs in 2014, including for their conformity to the Guidance.

- ▶ **Recommendation:** Perform a gap assessment, either internally or with the help of a third party, to determine whether your compliance program conforms to the Guidance.

Technical compliance with the Guidance will become especially important once an independent private sector audit is required, which for most companies will commence with the 2015 compliance period. In early January 2014, the AICPA published [guidance](#) concerning the procedures that may be followed by audit firms, as discussed in our [Alert](#). The Auditing Roundtable also published [guidance](#) in March 2014.

Conflict Minerals Rule Compliance Requires a Multi-Disciplinary Team

At many companies, Conflict Minerals Rule compliance has thus far primarily been a supply chain initiative, with the focus mostly on product scoping, data gathering and validation of vendor responses. As companies move into the next phase of compliance, other functional areas of the organization that have to date had less involvement with the compliance program will take on a bigger role. Legal (and at many middle-market companies, Finance) will have significant involvement with the preparation of the [Form SD](#) and Conflict Minerals Report. Internal audit may be involved with assessing the adequacy of the substance and documentation of the compliance program. As disclosure is crafted and the communications strategy is developed, Investor Relations and Corporate Social Responsibility also should have a seat at the table, to the extent that these functions reside in-house, since responsible minerals sourcing will be relevant to some of the constituencies that they interact with.

- ▶ **Recommendation:** Determine whether you have involved the internal personnel necessary for the next phase of compliance. If you have not already done so, prepare a clear, achievable timetable and responsibility checklist so that all team members know what is expected of them. Most newer team members will not have as much familiarity with the Rule and the Guidance as the project leads, so expect that additional education will be needed for them to fulfill their responsibilities.

Expect the Focus on Responsible Commodities Sourcing to Increase

The European Commission proposed its long-awaited conflict minerals regulation on March 5, 2014. Please see our separate [Alert](#) describing this legislation and providing takeaways for U.S. registrants and other companies.

A Canadian Conflict Minerals Act also has been introduced. Although adoption of the Canadian Act is remote at the present time, it further underscores the broad focus on responsible conflict minerals sourcing.

To date, two states — California and Maryland — have adopted legislation and two states — Connecticut and Massachusetts — have proposed their own, more limited conflict minerals legislation. If the Conflict Minerals Rule is vacated, we expect that additional state conflict minerals legislation will be proposed, whether requiring disclosure and/or pertaining to procurement by the state or the investment of state funds.

The focus on responsible sourcing is not limited to conflict minerals. Over the last few years, there has been increased focus on responsible sourcing of other commodities, such as cocoa, cotton and timber, to name a few.

Expect the focus on responsible commodities sourcing to increase further, whether in the form of legislation or pressure from NGOs, socially responsible investors and other stakeholders.

► **Recommendation:** Companies should implement a flexible and scalable conflict minerals compliance program that can, at a minimum, accommodate additional geographies and ideally also additional commodities. Doing so will enable you to more effectively and efficiently meet new responsible sourcing demands.

A New Year Means a New Compliance Period

The Rule requires reporting on a calendar year basis. Therefore, even though the first report is not due until mid-2014, a new compliance period began on January 1. Last year was a baseline year for most companies. It took many companies a significant portion of the year to determine the applicability of the Rule to their business activities and which products were in scope and to organize and begin their vendor outreach. And, as expected, relatively few vendors thus far have much visibility on their supply chains.

NGOs and socially responsible investors recognize that compliance will continue to evolve. They do not expect perfection in the first year, or even the first few years. However, they will expect companies to articulate a plan for progressive improvement and to implement that plan.

Although corporate customers also recognize the evolving nature of responsible minerals sourcing, as indicated earlier, supply chain intermediaries should expect some larger customers to begin to focus more on their suppliers' conflict minerals compliance programs, including the progress that has been made in tracing the supply chain and the vendor's strategy for improvement.

► **Recommendation:** As companies move into 2014, they should focus on how to improve the efficiency and effectiveness of the compliance program. As part of this process, determine what steps to take this year to further enhance supply chain traceability so that vendors provide more complete information in 2014. In many cases, this will require a multi-pronged proactive approach. Other common compliance issues that companies will need to focus on include survey timing, risk mitigation and incorporation of conflict minerals compliance into new product launches and vendor onboarding.

The Legal Challenge to the Rule Continues, But Is (Finally) Drawing to a Close

Like many other Dodd-Frank rulemaking initiatives, the Rule was challenged in court. The District Court for the D.C. Circuit upheld the Rule during July 2013. As expected, the decision was appealed. Oral arguments in the appeal were held on January 7. We expect the court to render its decision sometime before the first report is due.

If the Rule is upheld, companies that postpone or slow down their compliance efforts pending the court's decision are unlikely to be able to complete their work on time. And, in fact, since early 2014, we have seen the opposite trend. Many companies that slowly had been ramping up their compliance now have a much greater sense of urgency, in some cases bordering on panic.



SRZ's Conflict Minerals Resource Center

Schulte Roth & Zabel is the only law firm to have an online Conflict Minerals Resource Center. This frequently updated resource contains an extensive collection of SRZ-authored materials and webinars, U.S. government and EU resources, NGO materials, industry group resources and form documents to assist in compliance with the Rule. Subscribe to receive conflict minerals information through the SRZ online Conflict Minerals Resource Center at www.srz.com/Conflict_Minerals_Resource_Center.

Even if the Rule is vacated, for many companies, this will not mean pens down. Many larger companies — in a variety of industries, not just electronics — intend to continue implementing their 3TG traceability and responsible sourcing initiatives. This will put pressure on the entire public and private company supply chain to continue to implement their compliance programs as well.

And, if the Rule is vacated, expect varying degrees of pressure from other constituencies to maintain responsible sourcing momentum, such as NGOs, socially responsible investment funds, public pension funds and consumers. Therefore, although the SEC filing requirement may go away, at least temporarily, at a significant number of companies, the other elements of the compliance program will remain in place.

Even if the Rule is vacated by the court, for many companies, this will not mean pens down. There will be pressure on the entire public and private company supply chain to continue to implement their compliance programs.

► **Recommendation:** Companies should continue moving forward with their compliance, given that the court decision may not be forthcoming for some time and because of the other pressures that they are likely to face to responsibly source conflict minerals.

Reporting Involves More Than Just Getting the Facts Down on Paper

The 2013 compliance period will end with the filing of the first Form SD by the close of business on June 2, 2014 (because May 31 is a Saturday this year, companies have until June 2 to make their filings). Most companies also will need to prepare a Conflict Minerals Report, to be filed as an exhibit to the Form SD.

Like most other SEC rules, the Rule is a principles-based rule. The filing is not a blank form to be mechanically filled in. Therefore, significant judgment will go into preparing the filing. Companies will need to prepare disclosure that is tailored to their particular facts and circumstances. In addition, the SEC has indicated that companies have flexibility on how they craft certain disclosures. Finally, absent further clarification through FAQs, in some respects, what must be disclosed is open to interpretation.

► **Recommendation:** If you have not already begun preparation of your disclosure, we recommend doing so. Even those companies that are still collecting and analyzing vendor data generally have a good sense of what the final conclusions from their vendor outreach will be.

No, the filing will not take full-time effort between now and the end of May to draft. However, as a new filing obligation and first time effort, expect that the filing will go through many revisions and layers of review, especially at larger companies. Also expect that there will be different views internally as to what the disclosure should say. And, at many companies, the preparation and review will coincide with proxy season and the preparation and filing of the first quarter 10-Q, which will limit the amount of time that some team members will be able to devote to the filing.

By starting now (if they have not already done so), companies will be able to avoid missed deadlines and ensure sufficient time to address comments and concerns. In addition, by getting the disclosure down on paper now, you will be able to better evaluate how your compliance efforts may be perceived by external constituencies and, if needed, will have time before filing to further enhance and describe compliance procedures.

► **Recommendation:** If you have not already done so, also determine who will sign the Form SD. The report is required to be signed by an executive officer, which is defined in [Rule 3b-7](#) under the Exchange Act. Also determine who else must sign off on the filing (such as legal, a disclosure committee and/or the audit committee) and what back-up the signatory and other relevant internal constituencies will require as part of the sign-off process.

A very limited number of companies are expected to need an independent private sector audit for 2013, since most companies should be able to rely on the DRC conflict undeterminable audit exception. However, companies should determine whether they want to in any case put their program through an external compliance review or gap analysis before filing, which will accelerate the timing of the completion of documentation. This year, market practice in this regard is mixed.

As indicated earlier, to help ensure a smooth filing process, we recommend putting together a filing calendar that sets out key dates and responsibilities.

There Is More to Disclosure Than the SEC Filing

In addition to filing a Form SD and potentially a Conflict Minerals Report with the SEC, the Rule requires a registrant to disclose information from the filing on its website.

► **Recommendation:** Determine where on your website to place your disclosure. The Rule does not specify where the disclosure must reside. For example, it might be placed on the investor relations website, with other corporate and social responsibility information or under its own heading with a link from the main page.

In addition, many larger companies prepare a CSR report or otherwise publish CSR information. Conflict minerals disclosure should sync up with these other communications, both substantively and from a timing perspective.

The Audience for Your Disclosure Is Likely To Be Broader Than Just the SEC

Many companies are fixated on what the SEC will think about their disclosure. Of course compliance with the disclosure and substantive requirements of the Rule is important. However, the SEC will not be second-guessing companies' good faith compliance efforts and, like with other new complex rules, will give disclosure practices time to develop.

It is a recurring theme in this *White Paper* that many different constituencies, not just the SEC, will be focused on conflict minerals disclosure. These constituencies will differ among companies but will include generally NGOs, socially responsible investors, public and union pension funds, CSR research and ranking firms, consumer groups and consumers, customers and competitors, and even employees and prospective hires. Many of these constituencies view compliance with the Rule as the floor, rather than the ceiling. For additional insight on what some of these constituencies will be looking for in your disclosure, watch our [webinar](#) on this topic.

► **Recommendation:** Based on your industry, business and investor base, as well as your CSR profile and experiences with other CSR issues, determine which constituencies, if any, are most likely to focus on your disclosure, what you want to communicate to them, and what they are likely to take away from your disclosure.

As part of this process, also consider whether to put out supplemental disclosure concerning your conflict minerals sourcing, beyond the minimum requirements of the Rule, whether in the Form SD and Conflict Minerals Report or supplementally through other channels. For example, the Enough Project and the Responsible Sourcing Network have put out a [report](#) detailing their qualitative and quantitative expectations for conflict minerals reporting.

For some larger companies, proactive engagement with key external stakeholders also may make sense.

Conflict Minerals Rule Compliance Can Contribute to the Bottom Line

For most companies, 2013 was the year for getting up to speed on the Rule and beginning to implement their compliance programs. If they met these goals, they were satisfied. In 2014, many companies intend to proactively seek a quantifiable return on their compliance investment.

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► **Recommendation:** Determine whether the data gathered in connection with the Rule can be used for other business purposes. For example, in 2013, some companies used the Rule as a catalyst for assembling for the first time a centralized database of vendor compliance personnel, enabling them to more efficiently disseminate compliance communications and track vendor responses. At some companies with a decentralized procurement function, the data gathered in connection with the Rule is being used to identify common vendors and opportunities for volume pricing and vendor consolidation, as well as pricing discrepancies among business units. Many supply chain experts predict that companies will be able to recoup their compliance investment many times over, especially since compliance with the Rule has been significantly less costly for many companies than initially feared.

Also consider whether your compliance efforts can be positioned as a competitive advantage. For example, some component suppliers with robust conflict minerals compliance programs may want to position this to their customers as mitigating supply chain risk. Some other companies that are far along with their conflict free sourcing efforts have also publicized it. In January 2014, at the Consumer Electronics Show, the chief executive officer of Intel Corporation announced that Intel's processors are now conflict free. In February 2014, Apple Inc. announced that it is sourcing tantalum from conflict-free sources. These announcements were widely picked up in the press.

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Michael R. Littenberg is a partner in Schulte Roth & Zabel's Business Transactions Group and heads the firm's public companies practice. His principal areas of focus are corporate finance — across a broad range of equity and debt products — and mergers and acquisitions. As a significant part of his practice, Michael also counsels both domestic public companies and foreign private issuers and their boards, board committees, special committees, executive officers and investors in connection with ongoing compliance under the U.S. securities laws, including under Dodd-Frank, Sarbanes-Oxley and the JOBS Act, and with exchange requirements, as well as on governance and executive compensation matters. His public company clients range from well-known large-cap companies to growing micro-cap companies and his experience spans every major industry.

Michael has been especially active in advising companies on the SEC's Conflict Minerals Rule. In addition, he is the most widely quoted and published attorney in the United States on the Rule.

Michael is a frequent speaker at conferences and seminars, has authored numerous articles and is frequently quoted as an expert in the business and specialty press on topics pertaining to his areas of expertise. Michael is listed in *Who's Who in Securities Law* and in *New York Super Lawyers* for securities and corporate finance and was voted by his peers to *New York Super Lawyers Top 100 Lawyers* in the New York Metro area (multiple years).

Michael received his J.D., *magna cum laude*, from Tulane University Law School, where he was an editor of the Tulane Law Review and a member of the Order of the Coif, and his B.S. from Indiana University.



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Farzad also advises public and private companies on the SEC's Conflict Minerals Rule and writes and speaks extensively on the topic. Farzad is listed in *New York Super Lawyers Rising Stars* for securities and corporate finance and governance and compliance.

A member of the American Bar Association and the Bar Council of Maharashtra and Goa, Farzad received his LL.M. from Chicago-Kent College of Law, Illinois Institute of Technology, LL.B. from Government Law College in Bombay, India, and B.A. from St. Xavier's College in Bombay, India.



Complexity. Clarified.

Conflict Minerals Rule compliance is one of the more complex compliance projects ever undertaken by most companies. That's why many public and private companies across a wide range of industries are turning to Schulte Roth & Zabel to help them with their Conflict Minerals Rule compliance program.

A leader in Conflict Minerals Rule compliance, SRZ has been actively advising on responsible minerals sourcing since long before the adoption of Dodd-Frank. Our experience in this subject area spans a broad range of activities, from the initial stages of compliance, through reporting and beyond.

Find out how we can help you to efficiently and effectively establish and administer your Conflict Minerals Rule compliance program.

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Schulte Roth & Zabel is also the only law firm to provide an online Conflict Minerals Resource Center with frequently updated proprietary and other materials to assist in compliance with the Rule.

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About SRZ's Conflict Minerals Rule Practice

SRZ has a leading Conflict Minerals Rule compliance practice advising public and private companies and trade associations on the application of the Rule and the OECD framework. For further information concerning SRZ's Conflict Minerals Rule compliance practice, please contact **Michael R. Littenberg** at michael.littenberg@srz.com or +1 212.756.2524.

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