HUNTON& WILLIAMS

Conflict Minerals – Compliance Guide

Best Practices for Complying with the New Conflict Minerals Disclosure Requirements

Summary

Effective January 1, 2013, companies that file Exchange Act reports with the SEC are required to identify whether their products contain certain "conflict minerals" originating from the Democratic Republic of Congo and adjoining countries (the Covered Countries). Given the complexities of the rule and the cooperation needed for compliance initiatives, companies should take action now to identify their products that may contain conflict minerals and institute sourcing diligence measures to determine the source of such minerals. This client alert outlines certain best practices for complying with the new rules. For a detailed description of the new conflict minerals disclosure requirements, please see our companion client alert: *Conflict Minerals – Nuts and Bolts*. For more information on the open questions created by the new rules, a briefing on the industry group lawsuit challenging the new rules and an update on state, local and private conflict minerals initiatives, please see our companion client alert: *Conflict Minerals – FAQs and Recent Developments*.

Tips and Best Practices

Form a cross-function team to take responsibility for compliance and reporting. Unlike for most types of SEC compliance and reporting obligations, most reporting companies will not be able to rely solely on their law and finance departments to gather and analyze the information necessary to comply with the new rules. An effective team will also include members from the company's product design and engineering group, as well as the sourcing, commercial contracting and accounts payable functions. The team must have effective participation from many different functions in order to take the actions described below. In addition, the team may consider engaging outside counsel and/or consultants to help construct, evaluate and perform certain tasks (*e.g.*, supply chain tracking) in the company's compliance framework.

Create a timeline, budget and list of responsibilities. Once assembled, the team should treat the conflict minerals compliance initiative like any other major company project, and create a timeline, budget and responsibility plan.

Identify the reporting company's products. The SEC did not define "product," so reporting companies must make their own determinations in identifying their products. In addition to their core businesses, reporting companies must look at their ancillary businesses as well. This may involve evaluating complicated issues, such as evaluating contract manufacturing relationships, packaging, promotional items, etc. In making these determinations, the team should be mindful of how the company describes its "business" in its most recent annual reports and public disclosures.

Determine the make-up of the reporting company's products. The team should include, or involve, engineers, scientists and others who understand the make-up and design of the reporting company's products (and their components), in order to evaluate whether conflict minerals are "necessary" to those products. Specifications, schematics, formulae and ingredient lists will all need to be reviewed and additional inquiries from suppliers may need to be conducted to make these determinations. During the rulemaking, several commenters observed that companies at the top of the supply chain may not have complete visibility into whether conflict minerals are present in each individual part or component sourced from subcontractors. Manufacturers may not historically have tracked the country of origin or specified the metallic composition of rudimentary parts such as nuts, bolts, screws, fasteners and the like. Yet the absence of a *de minimis* standard in the final rules means that the *metallic* content of such items must be considered as part of the broader conflict minerals analysis.

***Contact suppliers, update agreements and create annual certifications*.** A reporting company that determines that its products do contain necessary conflict minerals should map its supply chain, reach out to the relevant suppliers of those minerals (or the components that contain those minerals) and communicate the cooperation that will be required for the company to comply with the new rules. The team should review the relevant supply agreements and, if possible, amend them to include language outlining the supplier's obligations (*e.g.*, annual certifications, prior notice of sourcing from a Covered Country, etc.). Flow-down clauses that require subcontractors and sub-suppliers to comply with the rules may be prudent, depending on the nature of the reporting company's business. The team should also prepare a form of annual certification that it expects to receive from its suppliers of conflict minerals regarding the origin of those minerals. As noted above, the SEC indicated that reporting companies may reasonably rely on such certifications in the absence of warning signs, and they will be useful in conducting the reasonable country of origin inquiry (RCOI) and, if necessary, further due diligence.

***Create clear internal certification and reporting obligations*.** Form SD must be "filed" and signed by an executive officer of the reporting company (the exact executive officer is not specified). The team should determine which executive officer will be responsible for signing Form SD, and then create a framework for providing that executive officer with the certifications and information necessary to back up the information in the Form SD. Reporting companies should work within their current internal reporting framework; however, this framework will likely need to be expanded to include additional functions (*e.g.,* sourcing and product design) that may not currently be involved in the reporting company's SEC reporting. An effective framework will clearly delineate which persons or functions are responsible for gathering and certifying as to each of the required disclosures in Form SD and, if necessary, a Conflict Minerals Report (CMR). As further explained in our companion release *Conflict Minerals – FAQs and Recent Developments*, a reporting company's disclosure controls and procedures may also be impacted by the new rules.

Maintain appropriate records of key determinations. The rule does not require a reporting company to retain reviewable business records to support its determinations, including its RCOI determination. We, however, recommend that reporting companies maintain appropriate records since they may be useful in demonstrating compliance with the rule and defending a company's final analysis. For example, a reporting company should document all key determinations made during its compliance process, including its findings regarding whether each of its products contains conflict minerals and, if a product does contain conflict minerals, whether such minerals are "necessary" to the product. Moreover, maintenance of records may also be required by a nationally or internationally recognized due diligence framework applied by the company.

***Test with a pilot program*.** To test its work plan, the compliance team should consider creating a pilot program and start with one company product, or a group of similar products. The related preliminary group of suppliers should be identified, and the team can test its communication plan, certifications and further diligence efforts prior to implementing its plan on a firmwide basis. This can be especially useful for companies with multiple products, products incorporating numerous parts and complex supply chains.

Draft a conflict minerals policy and make it available. Several companies have drafted and publicized their policies regarding their use of conflict minerals. Companies may consider adding a conflict minerals section to their current social responsibility statements or policies, or crafting a stand-alone policy. Such policies typically articulate the company's abhorrence of armed conflict and human rights abuses, express support for conflict minerals initiatives and legislation and describe the company's efforts to ensure its use of conflict-free conflict minerals. The policies can be useful in dealing with suppliers, as well as advocacy groups. The policies are typically included on the company's publicly available Internet website. Given the significant attention and publicity surrounding the conflict minerals issue, policies should be straightforward, factual and defensible and they should avoid excessive puffery. Advocacy groups have

begun challenging companies whose stated policies differ significantly from those observed on the ground.

Create an adaptable framework for ongoing compliance. The team should create a set of responsibilities within its organization that are designed to adapt to changes in a reporting company's business. As an example, a company's innovation or new products group should be educated about the new rule and a process should be implemented so that as new products are being developed, the team can evaluate the products' designs to identify potential uses of conflict minerals and whether commercially viable alternatives to conflict minerals should be considered.

Join industry groups and monitor industry trends and standards. Several industry groups have taken steps to assist their constituent companies in complying with the new rules. In the electronics industry, for example, the Electronic Industry Citizenship Coalition (EICC) has been at the forefront of the conflict minerals issue by creating a code of conduct for suppliers and member companies and, through its joint efforts with the Global e-Sustainability Initiative (GESI), creating the Conflict Free Smelter Program, as well as a supply chain reporting template and dashboard software. Several other industry groups and initiatives (*e.g.*, the Conflict-Free Tin Initiative (CFTI)) are also being developed. In addition, reporting companies should look to their peers to keep abreast of whether industry standards are developing regarding supplier certifications, conflict-free designations, due diligence practices and form and content of required disclosures.

If necessary, consider which firm the reporting company would retain to perform the independent private-sector audit. Reporting companies should consider which firm they might retain to conduct the independent private-sector audit if they are required to file a CMR. The audit committee should be involved in deciding whether the company should retain its current independent public accountant to perform the audit, or whether another firm should be retained.

Constructively engage the advocacy and NGO community. Various advocacy groups and NGOs have not only been active participants in crafting Section 1502 and the SEC's rules, but have also announced their intention to monitor prominent companies' compliance and reporting practices. Many socially focused investor groups have also weighed in on the rules and intend to scrutinize compliance. Several of these groups have begun grading various companies' existing compliance based on various objective and subjective factors, ultimately publishing governance scores or similar kinds of ratings. While each reporting company will manage its relationship with these advocacy groups differently based on its own facts and circumstances, companies may find benefits in engaging these groups in a constructive way. Such engagement could lead to a better understanding of advocacy groups' expectations, as well as better communication to mitigate any potential concerns.

Ready to Assist

We have assembled an interdisciplinary team of lawyers experienced in commercial contracting, corporate governance and securities law compliance who stand ready to assist both public and private companies in their compliance efforts. We are able to provide assistance on a wide variety of matters, including reviewing and revising current supply agreements, drafting annual supplier certifications, advising on internal compliance structures and preparing the necessary SEC disclosures. We are also ready to advise private companies as they cooperate with their reporting company partners on their compliance efforts. Please feel free to contact your regular Hunton & Williams attorney or any of the lawyers listed on this client alert.

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