

The SEC's Conflict Minerals Rule

An Overview for Companies in the Jewelry Industry

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Under Dodd-Frank, the SEC has been tasked with adopting rules that will require public companies to disclose their use of conflict minerals, with enhanced diligence and disclosure obligations for minerals originating in the Democratic Republic of Congo and its neighboring countries. The rule is intended to reduce a significant source of funding for armed groups that are committing human rights abuses in the DRC.

Although the conflict minerals rule technically applies only to public companies, it will have a significant impact on any company anywhere in the world, public or private, that is part of a public company's supply chain. In order to meet their obligations under the rule, public companies will need to collect supply chain information from their suppliers. Therefore, a significant number of private company suppliers - including in the jewelry industry - also will need to be familiar with the conflict minerals rule and the obligations that their direct and indirect customers are likely to place on them.

"Conflict minerals" consist of four specific minerals and their derivatives. The first three are cassiterite, columbite-tantalite (coltan), wolframite and their derivatives, which include tin, tantalum and tungsten and are often referred to as the "three T's." The fourth mineral, which has the most significance for the jewelry industry, is gold.

The conflict minerals rule is awaiting final adoption, which the SEC has indicated is expected to occur by the end of June 2012. Under the rule as proposed, public companies that use conflict minerals in their products or production processes must conduct diligence to determine whether the conflict minerals used originated in a DRC country. To the extent that the conflict minerals used originated in a DRC country, were from an unknown source or were from scrap or recycled sources, then the public company must conduct additional supply chain diligence and prepare a Conflict Minerals Report. Under certain circumstances, third party products that are sold by retailers do not come within the scope of the rule.

Among other things, the Conflict Minerals Report must describe the measures that the public company took to exercise due diligence on the source and chain of custody of its conflict minerals. The Conflict Minerals Report also must indicate any of the public company's products that are not "DRC conflict free," which are those products that contain conflict minerals that originated in certain regions of the DRC countries or are of unknown origin. The Conflict Minerals Report is required to be audited and must be furnished with the public company's annual report.

To the extent possible, most public companies are expected to preemptively make changes to their supply chains in order to avoid having to disclose that their products are not "DRC conflict free." As proposed, the conflict minerals rule will take effect for a given public company beginning with its first full fiscal year after the SEC adopts the final rule, although the SEC has indicated that the final rule will contain a yet-to-be disclosed phase in period.

Diligence under the conflict minerals rule involves a three step inquiry, with increasing levels of diligence and disclosure depending upon a company's use of conflict minerals and their area of origin.

Step One requires a company to first determine if conflict minerals are necessary to the functionality or production of a product it manufactures or contracts to be manufactured.

If a company determines in its Step One diligence that conflict minerals are necessary to the functionality or production of a product it manufactures or contracts to be manufactured, it must move on to Step Two of the diligence process. Step Two requires a reasonable country of origin inquiry to determine whether the conflict minerals used originated in a DRC country. What constitutes a reasonable inquiry will require a "facts and circumstances" determination.

If a company determines that any of its conflict minerals originated in a DRC country, are from an unknown source or are scrap or recycled, then it must go on to Step Three, which, as discussed above, requires additional diligence and the preparation of a Conflict Minerals Report.

Various industry initiatives are underway to help companies comply with the conflict minerals rule. The Responsible Jewelry Council has developed the RJC System, which is a certification system for the diamond and gold jewelry supply chain. Each RJC member organization must be audited by an accredited third party to verify its compliance with the RJC's ethical, human rights, social and environmental standards. Although the RJC system was not developed specifically for conflict minerals rule compliance, the RJC has new chain-of-custody certification standards under development that will be tailored for compliance with the rule. The RJC also intends to make these standards publicly available as an informational resource to non-members.

Until a final rule is adopted, it is premature for companies to build out a conflict minerals rule compliance program. However, companies that have not yet done so, should familiarize themselves with the proposed rule, assess the risks it presents to their business and develop an action plan for complying with the final rule once adopted.