Conflict Minerals Rule Adopted

Compliance Considerations for Privately-Owned Companies in the Jewelry Industry

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In the April 2012 issue of Diamond District Monthly, I discussed the SEC's proposed conflict minerals rule. On August 22nd, after a protracted rule-making process, the final conflict minerals rule was adopted. The good news is that the final rule is less onerous for companies than the proposed rule in many important respects. However, although the conflict minerals rule technically applies only to public companies, it still 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 compliance obligations under the rule, public companies will need to collect supply chain information from their suppliers. Therefore, tens, and perhaps hundreds, of thousands 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 public company customers are likely to place on them.

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

Under the rule, if any of a public company's products contain conflict minerals, the public company must conduct diligence to determine whether the conflict minerals originated in the Democratic Republic of the Congo or one of the nine neighboring countries, which are referred to in the rule as "covered countries," or whether they are from recycled or scrap sources. To the extent that the conflict minerals contained in its products originated or are believed to have originated in a covered country, the public company must conduct additional supply chain due diligence on the source and chain of custody of the conflict minerals and prepare a Conflict Minerals Report. Even if the conflict minerals are not from a covered country or are from recycled or scrap sources, the determination still must be publicly reported on Form SD, a new SEC form.

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 have not been found to be "DRC conflict free," which are those products that contain conflict minerals that may have originated in certain regions of the DRC countries where human rights abuses are being committed. The Conflict Minerals Report generally is required to be audited.

Public companies are not required to make their first disclosures under the conflict minerals rule until May 31, 2014. However, these disclosures will relate to the 2013 calendar year. As a result, public companies and their private suppliers should strive to have their conflict minerals compliance programs up and running by January 1, 2013.

To the extent possible, many public companies are expected to make changes to their supply chains in order to avoid or at least mitigate having to disclose that their products have not been found to be "DRC conflict free." Therefore, it is incumbent upon private suppliers to be able to confirm to their public company and other intermediate customers the source of the conflict minerals contained in their products.

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 public company to first determine if conflict minerals are necessary to the functionality or production of a product it manufactures or contracts to be manufactured. Whether conflict minerals are "necessary" to a product or the product is contract manufactured for a public company will in many cases require a subjective analysis, although the SEC's 350+ page adopting release for the rule provides some guidance.

For example, in a reversal from the proposed rule, the SEC's adopting release indicates that a public company generally will not be considered to have contracted to manufacture a product if it does no more than affix its name to a generic product. Merely specifying or negotiating contractual terms not directly related to the manufacture of the product also will not by itself constitute sufficient influence over the manufacturing process by a public company to trigger the application of the rule. These exceptions will exempt from the rule's coverage many, but certainly not all, products manufactured by privately held companies in the jewelry industry.

If a public 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 contained in the product originated in a covered country or are from recycled or scrap sources. What constitutes a reasonable inquiry will require a "facts and circumstances" determination.

If a public company determines or has reason to believe that any of the conflict minerals contained in its products originated in a covered country and are not from recycled or scrap sources, then it must go on to Step Three, which, as discussed above, requires enhanced due diligence and the preparation of a Conflict Minerals Report.

Various industry initiatives are in place or in development to help companies comply with the conflict minerals rule. For example, The Responsible Jewellery Council (RJC) has introduced its Chain-of-Custody (CoC) Standard. The CoC Standard sets requirements for companies with the goal of verifying the source of gold and platinum. RJC members that follow the Standard can apply to be certified as compliant by the RJC after an audit. To be certified as responsibly sourced, a company's gold and platinum must, at a minimum, come from conflict-free sources. The RJC also has made the Standard publicly available on its website as an informational resource for non-members.

Now that a final conflict minerals rule has been adopted, there are a number of basic compliance steps that all private companies in the jewelry industry should take to the extent that they are directly or indirectly part of a public company's supply chain.

First, become familiar with the final conflict minerals rule. A more extensive White Paper summarizing the final rule and a diligence outline that I have prepared are available at www.srz.com.

Second, based on your particular products, who you sell to and their involvement in the manufacturing process, consider whether your products might come within the scope of the rule.

Third, to the extent that the conflict minerals rule is applicable to your products, determine the compliance measures — such as certification requirements -- that you will need to put in place to satisfy the diligence obligations of direct and indirect public company customers, as well as any supplier changes that you may need to make.

Companies with larger product lines and more complex vendor and customer relationships will of course need to have more extensive conflict minerals rule compliance procedures.

January 1, 2013 — and the beginning of conflict minerals rule compliance — will soon be upon us. However, with proper planning, private companies in the jewelry industry can mitigate the impact of the conflict minerals rule on their business and ensure the stability of their vendor and customer relationships.