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Conflict Minerals Rule Challenged in Court — What Should Public and Private Companies Do Now?

Near-Term Action Items in Today's Uncertain Regulatory Environment

On Oct. 19, 2012, a lawsuit challenging the SEC's Conflict Minerals Rule was filed with the Court of Appeals for the D.C. Circuit by the National Association of Manufacturers and the U.S. Chamber of Commerce. An amended petition was filed a few days later adding the Business Roundtable as a petitioner. The [Petition for Review](#) and the [Scheduling Order](#) specifying near-term document submission dates by the petitioners and the SEC are available on Ropes & Gray's online [Supply Chain Compliance and Corporate Social Responsibility Resource Center](#).

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The challenge to the Conflict Minerals Rule was not unexpected. The petitioners previously indicated that they might challenge the rule. In addition, the successful challenge of mandatory proxy access and, more recently, the CFTC's position limits rule, the dissents of Commissioners Gallagher and Paredes in connection with the adoption of the Conflict Minerals Rule and the recent challenge of the SEC's new resource extraction disclosure rule all contributed to speculation that a challenge to the Conflict Minerals Rule was in the offing.

The Conflict Minerals Rule may be stayed pending the outcome of the case, although this has not yet occurred and, at least at this time, for various reasons, it is unlikely that the SEC will on its own initiative voluntarily stay the application of the rule. Unless the application of the Conflict Minerals Rule is stayed, the first compliance period under the rule will begin on schedule on Jan. 1, 2013.

Public companies and their suppliers are in the difficult position of having to determine how much effort and expense to incur in connection with their Conflict Minerals Rule compliance in light of the uncertainty surrounding the rule. The right answer for the vast majority of public companies and private suppliers is to stay the course for the time being.

The good news (and, depending upon one's perspective, bad news) for most companies is that they still are in the early stages of developing their Conflict Minerals Rule compliance programs and have significant ground to cover before they get to the heavy-lifting under the rule, in particular the expensive and time-consuming exercise of supply chain mapping and diligence and enhancements to IT systems. Therefore, in most cases, company compliance personnel are not yet in the uncomfortable position of having to advocate internally for immediate approval of significant budget items needed to comply with a rule that ultimately may be struck down or delayed.

Furthermore, even if the Conflict Minerals Rule ultimately is stayed pending the resolution of the court challenge or struck down, the usage of conflict minerals that are not "DRC conflict free" will remain a focus of the NGO community, socially responsible investors and consumer groups.

Many public companies also are keeping the pressure on their suppliers to engage in traceable conflict free sourcing. Some large companies, in particular in the consumer electronics industry, already have expended significant effort to establish conflict free supply chains and, irrespective of the outcome of the challenge to the Conflict Minerals Rule, are expected to continue these initiatives. Even if they slow down their own compliance efforts while the challenge to the rule is pending, many other public companies continue to aggressively push Conflict Minerals Rule

compliance down the supply chain because they can do so at relatively little cost to themselves, requiring suppliers to engage in conflict free sourcing and implement compliance programs to be able to provide the information that public companies will need to satisfy their diligence and reporting obligations under the rule.

Public companies are driving conflict free sourcing in their supply chains for many different reasons. Some are doing so to ensure that they are not caught short in the event that the Conflict Minerals Rule is upheld or takes effect on schedule. Others are doing so as part of their broader corporate social responsibility program or to obtain at least a temporary competitive advantage in the marketplace. Still others are doing so primarily to mitigate the risk of adverse publicity, boycotts, customer loss or shareholder proposals relating to conflict minerals usage. Whatever the motivation, in each case the result is the same — companies up and down the supply chain will need to stay focused on Conflict Minerals Rule compliance and the creation of a conflict free supply chain generally.

Even in the current unsettled regulatory environment, companies in the earlier stages of their Conflict Minerals Rule compliance should consider the following near-term action items, to the extent not already taken or in process. These items come from our extensive practical experience advising on the Conflict Minerals Rule.

Assembling the Team

- Create an internal Conflict Minerals Rule compliance team. For most companies, the internal team should consist, at a minimum, of representatives from manufacturing, engineering, procurement, IT, finance, internal audit and legal. Corporate social responsibility and investor relations should be represented as well to the extent those functions reside in-house.
- Empower the team leader. Conflict Minerals Rule compliance is one of the most complex compliance projects ever undertaken by many public companies and requires significant cooperation across locations, divisions and departments. At many companies, it has been a slow, difficult process to achieve the requisite level of internal cooperation to move Conflict Minerals Rule compliance forward effectively. Senior management should empower the project leader with the authority to develop and implement the compliance program and create the appropriate incentives to ensure cooperation.
- Establish a point person to address questions on the Conflict Minerals Rule. This may be the team leader or, in a larger organization, perhaps one of his or her reports. Designating a point person for inquiries will make it more likely that important questions concerning the Conflict Minerals Rule get asked and will help ensure that the rule is applied consistently throughout the organization. Furthermore, as certification requests and contract amendment requests are received, these also will need to be dealt with consistently throughout the organization.
- Consider whether one or more additional internal hires are needed to manage the Conflict Minerals Rule compliance program.
- Consider whether the internal team needs to be supplemented by specialist outside counsel. Outside counsel can assist in developing the compliance program, educating personnel on the requirements of the Conflict Minerals Rule, advising on interpretive questions and helping to construct compliance policies, craft supplier communications and certifications, determine modifications to form contracts and prepare Conflict Minerals Rule disclosure.
- Consider the need for other outside consultants. Other consultants can, among other things, assist in analyzing the supply chain and supply chain risk, developing and assessing the effectiveness of diligence procedures and advising on and implementing enhancements to IT systems.

Getting Up to Speed

- Conduct internal training sessions on the Conflict Minerals Rule for relevant personnel. Given the complexity of the rule, at most companies, it is unrealistic to expect personnel to have a good understanding of the rule based solely on a written summary.
- Become familiar with the OECD conflict minerals due diligence framework, since it is currently the only recognized framework for Step 3 due diligence.
- Become familiar with other relevant NGO recommendations and industry initiatives, as well. In many cases, companies will want to piggyback on industry-wide diligence initiatives to reduce compliance costs.
- [Subscribe](#) to receive conflict minerals information through the Ropes & Gray online [Supply Chain Compliance and Corporate Social Responsibility Resource Center](#). The Resource Center has a wealth of information on the Conflict Minerals Rule and is frequently updated.

Scoping Out the Compliance Project

- Determine, at least on a preliminary basis, the products that may be implicated by the Conflict Minerals Rule. At companies without a centralized product database, this often is a cumbersome task.
- Catalogue current procurement policies and practices, supplier diligence practices and internal reporting and data gathering practices and capabilities relevant to Conflict Minerals Rule compliance in order to preliminarily determine areas that may require enhancement.
- Construct a work plan, timeline and budget for Conflict Minerals Rule compliance.
- Consider conducting a pilot compliance program. This will be especially important for companies with a complex supply chain to identify weaknesses and areas for improvement before the Conflict Minerals Rule compliance program is rolled out more broadly.
- Demo third-party Conflict Minerals Rule compliance software solutions. Many companies will need to look to third-party software solutions to assist with supply chain mapping and reporting, and there are several solutions competing for IT spend.
- Meet with supply chain consultants if some of the heavy lifting will need to be outsourced. Because this is a developing expertise with consultants at a wide range of price points, many companies will want to meet with several supply chain consultants before deciding which firm to hire.

Communicating the Rule and Compliance Program

- Update compliance manuals and policies to reflect the Conflict Minerals Rule and the company's compliance policy. Some companies have separate supply chain policies, while others include the principles in their social responsibility or equivalent policy.
- Send a written communication to relevant employees sensitizing them to the Conflict Minerals Rule, the company's compliance obligations under the rule and the company's compliance policy.
- Implement procedures to ensure that all certification and contract amendment requests relating to Conflict Minerals Rule compliance are sent to a knowledgeable employee for vetting. Many of the certifications and amendments that companies have been requested to sign thus far are overly broad and, as a practical matter,

impossible to comply with. Because of technical language used in the certifications and amendments, this often will not be evident to employees that are not familiar with the Conflict Minerals Rule.

Managing Suppliers

- Assemble a database of supplier personnel that should receive Conflict Minerals Rule compliance materials. Supplier compliance personnel will in many cases be different from regular supplier contacts, who typically are instead on the sales side of the organization.
- Send an initial written communication to suppliers sensitizing them to the final Conflict Minerals Rule and your company's compliance obligations thereunder.
- Consider whether to conduct sessions on the Conflict Minerals Rule for suppliers.
- Communicate your supply chain policy to suppliers.
- Develop supplier questionnaires and certifications and determine additional supplier documentation, diligence and compliance requirements. The supplier certification process should take into account industry recommendations and diligence initiatives to map common supply chains. Questionnaires and certifications also should capture information relevant to Step 3 of the due diligence inquiry to the extent applicable. In addition, consider whether to build into these materials forced labor and child labor elements, given evolving disclosure and legislative developments in those areas.
- Incorporate relevant elements of Conflict Minerals Rule compliance into contracts with suppliers, such as adherence to your company's supply chain policy, diligence and inspection rights, supplier disclosure, reporting and cooperation requirements and flow-down clauses.
- Develop a risk management plan that includes procedures for suspending or terminating suppliers that do not comply with your sourcing policies, as well as alternative sources for conflict minerals.
- Consider participating in the continuing development of industry supply chain initiatives.

Near-term Disclosure Considerations

- Many public companies already have included a conflict minerals risk factor in their public disclosure. However, if your company has not already done so, consider whether the risks relating to the Conflict Minerals Rule are significant enough to your particular business to merit a risk factor. The risk factor should reflect the uncertainty surrounding the final rule.
- If not already publicly available, consider whether to post your sourcing policy proactively on your website. Sites such as Rankabrand.org and Goodguide.com already are explicitly tracking conflict minerals policies.

A Few Other Items to Consider

- Conflict minerals that are "outside the supply chain" before Jan. 31, 2013 are not required to be reported on under the Conflict Minerals Rule. Conflict minerals are outside the supply chain if they were smelted or refined or outside of the covered countries before that date. In addition, products manufactured prior to 2013 are not captured by the Conflict Minerals Rule. Conflict minerals and products that are grandfathered under the Conflict Minerals Rule should be inventoried before the rule takes effect so that they can be excluded from diligence and reporting. In addition, consider whether to stockpile conflict minerals to mitigate the effect of the rule for 2013.

- Benchmark your supply chain policy and practices against your competitors to the extent their policies and practices are publicly disclosed.
- Participate in industry working groups. These groups are a good source of information as to how peer companies are addressing interpretive questions under the Conflict Minerals Rule.
- Consider the investor relations and shareholder implications of Conflict Minerals Rule compliance and conflict free sourcing generally. At a minimum, expect to receive questions from some institutional investors on conflict minerals usage and sourcing and the anticipated effect of the Conflict Minerals Rule on your company. Some investors may more actively seek to drive conflict free sourcing through shareholder proposals and voting policies. In any case, expect conflict free sourcing to become an increased focus of some institutional investors. Underscoring the increased emphasis on human rights generally by some institutions, in the last few weeks, the Louisiana Municipal Police Employees' Retirement System sued The Hershey Co. for access to internal records, alleging that Hershey was complicit in child labor violations by African cocoa suppliers.
- To the extent pursuing acquisitions, the Conflict Minerals Rule needs to be taken into account in due diligence and assessing risk.

For Further Information

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