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SEC Publishes Conflict Minerals FAQs Packaging Not Part of the Product; Confirms Other Prevailing Interpretations

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Late yesterday afternoon, the SEC published its first 12 FAQs concerning the Conflict Minerals Rule. Most significantly, the FAQs provide guidance on packaging that dramatically reduces or eliminates the compliance obligations under the Conflict Minerals Rule for some issuers. The remaining FAQs provide additional clarity concerning various aspects of the Conflict Minerals Rule, but are unlikely to have much impact on the ongoing development and implementation of most conflict minerals compliance programs, since these FAQs largely restate guidance contained in the Adopting Release or confirm prevailing interpretations. The FAQs of course only address a small number of the many day-to-day questions and issues that companies are wrestling with as they implement the Conflict Minerals Rule within their organizations.

The FAQs are summarized below. The full text of the FAQs is available here.

Ropes & Gray is a thought leader on the Conflict Minerals Rule. Our other articles on this topic are available at the Supply Chain Compliance and Corporate Social Responsibility Resource Center.

Packaging Is Not Considered Part of the Product

The prior uncertainty around the treatment of packaging has been particularly troublesome for many companies in the food and beverage and pharmaceutical industries, where packaging is often designed to preserve product freshness or stability and is therefore arguably necessary to the functionality of the product. The FAQ resolves this uncertainty, indicating that the packaging or container sold with a product is not considered to be part of the product, even if the packaging or container is necessary to preserve the usability of the product up to and following the product's purchase. The SEC staff notes in the FAQ that once the consumer starts to use a product, the packaging is generally discarded.

As a result of this guidance, many companies in the food and beverage and pharmaceutical industries will have no in-scope products and will therefore have no reporting obligations under the Conflict Minerals Rule. However, we recommend that companies still conduct a thorough internal analysis for potentially in-scope products. In our experience, many companies that preliminarily concluded that they did not have any in-scope products have reversed those determinations upon a closer examination.

Packaging and containers are still considered to be a product to the extent that the issuer manufactures and sells packaging or containers independent of the product that is ultimately included in the manufactured packaging or container.

Generic Components in Higher-Level Products Are Not Excluded from Compliance

The Conflict Minerals Rule does not distinguish between the components of a product that an issuer directly manufactures or contracts to manufacture and the generic purchased components included in the product. Therefore, to the extent that the issuer manufactures or contracts to manufacture a higher-level product, it must conduct a reasonable country of origin inquiry with respect to the conflict minerals contained in the generic components

included in that product. This FAQ is consistent with the Adopting Release and does not break new ground, although we have found this to be a continuing source of confusion among issuers.

Equipment Used to Provide a Service Is Not a Product

An issuer is not required to report on conflict minerals contained in equipment that it manufactures or contracts to manufacture to the extent that the equipment is used for a service provided by the issuer and that: (i) the equipment is retained by the service provider; (ii) is to be returned to the service provider; or (iii) is intended to be abandoned by the customer following the terms of service. The FAQ indicates that the SEC staff does not interpret equipment used to provide a service to be a product under the Conflict Minerals Rule. The example cited in the FAQ is conflict minerals contained in a cruise ship manufactured or contracted to be manufactured by a cruise line. However, this FAQ would presumably apply more broadly beyond the transportation and hospitality industries, for example also applying to companies in the telecommunications, media, power and oil and gas industries.

The Sale of Used Manufacturing Equipment Does Not Trigger Application of the Rule

The sale of used tools, machines or other equipment that an issuer manufactured or contracted to manufacture for use in the manufacture of its products does not come under the Conflict Minerals Rule. The FAQ indicates that the SEC staff does not view these items as products of the issuer, and the later entry of these items into the stream of commerce does not transform them into products of the issuer.

Inclusion of a Logo or Other Identifier on a Generic Product Does Not Cause the Product to Be in Scope

If an issuer has its logo, a serial number or other identifier etched into a generic product that is manufactured by a third party, that does not result in the issuer being deemed to have contracted to manufacture the product.

Reporting Obligations Are Determined on a Consolidated Basis

The Conflict Minerals Rule does not only apply to activities at the issuer level. Consolidated subsidiaries are captured in the issuer's compliance and reporting as well.

Issuers Have Flexibility in How they Describe Products in the CMR

The FAQ reiterates the position articulated in the Adopting Release that an issuer has flexibility in how it describes its products that have not been found to be DRC conflict free or that are DRC conflict undeterminable. The FAQ indicates that an issuer may describe these products based on its own facts and circumstances because it is in the best position to know its products and to describe them in terms commonly understood in its industry. For example, the FAQ makes clear that an issuer is not required to describe its products using model numbers. However, the FAQ notes that the description in the Conflict Minerals Report must state clearly that the products have not been found to be DRC conflict free or are DRC conflict undeterminable, as applicable.

A DRC Conflict Free Determination Triggers Reporting and an Audit

If an issuer determines that its covered products contain conflict minerals from the DRC or an adjoining country, but the products are DRC conflict free, it must prepare a Conflict Minerals Report and obtain an independent audit of the applicable portions of the report. However, the issuer is not required to disclose the products containing those conflict minerals in its Conflict Minerals Report or provide the product description information indicated in Item 1.01(c)(2) of the Conflict Minerals Rule, because those products are DRC conflict free.

Activities Customarily Associated with Mining Are Not Covered by the Rule

Mining is excluded from the Conflict Minerals Rule and is not an activity deemed to be equivalent to manufacturing. The FAQ clarifies that activities customarily associated with mining, including the mining of lower grade gold ore,

are not considered to be manufacturing of the minerals and are therefore excluded from the application of the Conflict Minerals Rule. For example, the FAQ notes that mining of lower grade gold ore often involves, in addition to mining the ore, transporting the ore to a processing facility, crushing and milling the ore, mixing crushed or milled ore with cyanide solution, floating cyanide mixture through a leaching circuit, extracting gold from a leached circuit, smelting the gold into ingots or bars and transporting the ingots or bars to a refinery for refining.

A Late Form SD Filing Does Not Affect Form S-3 Eligibility

The failure to timely file a Form SD does not cause an issuer to lose eligibility to use a Form S-3 registration statement. The Form S-3 requirement that a registrant timely file all reports and materials required to be filed during the prior 12 months refers only to filings under Sections 13(a), 15(d), 14(a) and 14(c) of the Exchange Act. Form SD is instead required to be filed under Section 13(p) of the Exchange Act.

Voluntary Filers Are Not Exempt

Voluntary filers are subject to the Conflict Minerals Rule.

IPO Issuers Can Take Advantage of a Transition Period Before they Are Subject to the Conflict Minerals Rule

The Conflict Minerals Rule permits an issuer that acquires or otherwise obtains control over a non-reporting company that manufactures or contracts to manufacture in-scope products to report on the acquired company's products beginning with the first calendar year that begins no sooner than eight months after the effective date of the acquisition. The FAQ indicates that the SEC staff will not object if an IPO issuer starts reporting for the first calendar year that begins no sooner than eight months after the effective date of its IPO registration statement.

For Further Information

If you would like to learn more about the issues in this Alert, please contact your usual Ropes & Gray attorney.

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