

What 2013 Conflict Minerals Filings Mean For 2014: Part 2

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On June 2, 2014, the first filings under the conflict minerals rule were due. This three-part article discusses these filings across a range of metrics and provides other qualitative observations on the filings. It concludes with takeaways and suggestions for calendar 2014 compliance and reporting.

More Filing Statistics

Survey Process

Survey Format

Seventy percent of the sample group indicated that they used the EICC/GeSI's Conflict-Free Sourcing Initiative ("CFSI") conflict minerals reporting template to survey their suppliers. The remaining 30 percent of the sample group indicated that they used a custom survey template or a template based on the CFSI template, or did not indicate the survey mechanism used.

In our experience, most issuers in the electronics industry used the template, given that industry's leadership in its development. A high percentage of companies engaged in manufacturing also used the template. In contrast, many retailers used a modified questionnaire, in many cases paper-based, out of concern that their supply chain generally did not have the sophistication or was less likely to complete the template. In contrast to many companies in the electronics industry, some retailers had a fairly small number of in-scope products and/or suppliers, so they were able to effectively manage paper-based and alternative questionnaire formats.

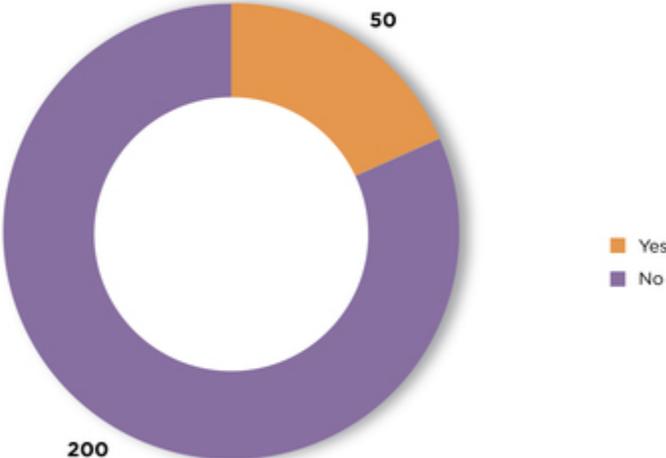
We expect usage of the template to further increase this year, including among retailers. We believe that most suppliers are now familiar with the template and how to complete it, as it is the de facto standard. In addition, usage of the template may increase the supplier response rate, since most suppliers also will need to complete the template for other customers.

The release in April 2014 of IPC-1755 also is likely to further increase usage of the template. IPC-1755 is a data exchange standard that was developed by IPC — [Association Connecting Electronics Industries](#) in partnership with several other industry groups, including the CFSI. IPC-1755 is XML-schema based, which allows for more efficient communication and quicker application of data across companies, supply chain levels and industries. IPC-1755 is compatible with the new revision 3.01 of the template.

Supplemental Materials

A small percentage (20 percent) of the sample group indicated in their filings, primarily in the CMR, that they furnished supplemental explanatory materials to suppliers with or in advance of commencing the survey process. These materials pertained to the survey process and the completion of the survey, the conflict minerals rule generally and/or the issuer's compliance expectations.

Chart 13: Supplemental Explanatory Materials Furnished to Suppliers – Sample Group

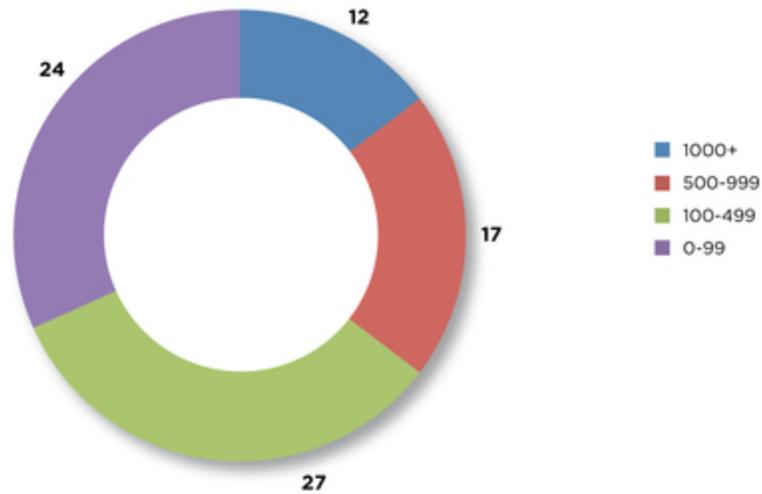


We believe that the use of supplemental materials was somewhat more widespread than indicated in the filings. However, as discussed in our recommendations later in this article, many issuers can still benefit from enhancing the materials that they provide to their suppliers.

Suppliers Surveyed and Response Rates

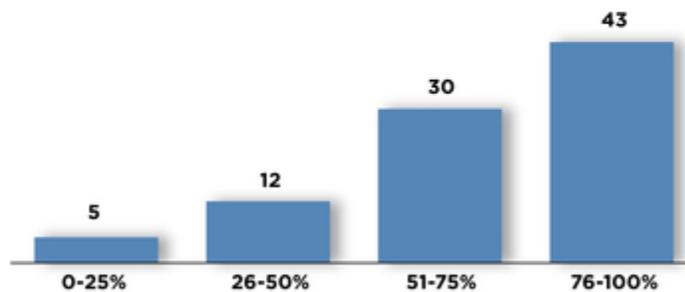
Slightly under one-third (32 percent) of the sample group indicated the number of suppliers surveyed. As expected, the number of surveyed suppliers varied significantly.

Chart 14: Number of Suppliers Surveyed — Sample Group



A slightly higher percentage of the sample group (36 percent) indicated their supplier response rate. In most cases, issuers that indicated the number of suppliers surveyed also indicated their response rate. Not surprisingly, issuers with higher response rates were more inclined to provide response rate disclosure. Almost half of the issuers providing response rates indicated a response rate of more than 75 percent, while another third indicated a response rate between 50 and 75 percent.

Chart 15: Supplier Response Rate — Sample Group



However, with few exceptions, sample group issuers did not describe what constituted a response. In other words, the disclosure did not indicate whether the response percentage included responses that contained inaccuracies or inconsistencies, that were incomplete or that were non-conforming (such as in a letter format). Based on the difficulty issuers experienced in obtaining complete, error-free responses, high response rates within the sample group are likely to reflect all responses received, without regard to quality.

Supplier Follow-Up and Review of Responses

Fifty-six percent of the sample group indicated that they followed up with suppliers that did not submit a response or that submitted a response that was believed to be inaccurate or incomplete. Although some of the sample group issuers that only filed a Form SD described their supplier follow-up, in most cases, the discussion was included in a CMR.

Accordingly, as a percentage of sample group CMR filers, the percentage of issuers that discussed their supplier follow-up was somewhat higher. Many sample group issuers indicated the form of follow-up (typically email, phone or mail) and some indicated their escalation process for nonresponsive suppliers.

A much smaller percentage of the sample group discussed their process for reviewing smelter and refiner information provided by suppliers:

- Less than 15 percent of the sample group indicated that they reviewed smelter and refiner information received from suppliers against published third-party lists of certified smelters and refiners.
- An even smaller percentage of the sample group indicated that they performed additional reviews on identified smelters and refiners that were not certified.

These percentages were low in part because a significant number of the sample group issuers that filed CMRs indicated that they were unable to obtain any smelter or refiner information from their suppliers.

In their initial comments on the calendar year 2013 filings, nongovernmental organizations and institutional socially responsible investors were especially critical of the level of disclosure relating to the review of supplier information, noting that they generally did not find the disclosure sufficient to demonstrate that companies performed a credible reasonable country of origin inquiry ("RCOI") or due diligence.

RCOI Discussion

The majority of the issuers in the sample group that filed a CMR included the substance of their RCOI within their discussion of the Organization for Economic Cooperation and Development guidance. The [U.S. Securities and Exchange Commission](#) has indicated that the RCOI required by the conflict minerals rule is consistent with the supplier engagement approach under the OECD guidance. Since most issuers utilized the OECD guidance for both their RCOI and due diligence, the discussion often was combined.

Risk Mitigation and Process Improvements

Sixty-two percent of the sample group issuers that filed a CMR indicated that they have devised a risk management strategy or implemented a risk management plan, or they discussed other elements of Step 3 of the OECD guidance. This percentage is roughly the same as the percentage that tracked the OECD guidance's five-step framework in their CMRs, although the two sample group subsets were not identical.

A slightly higher percentage of the sample group (68 percent) discussed or listed in their CMRs future steps to mitigate the risk that their necessary conflict minerals benefit armed groups, including steps to improve due diligence, although the steps listed varied among issuers.

Some of the areas of future improvement cited included:

- Continuing to implement various elements of the OECD guidance;
- Enhancing supplier training;
- Engaging with suppliers that provided incomplete information for calendar year 2013 or that did not respond to information requests;
- Encouraging suppliers to provide product level information;
- Monitoring and encouraging the continued development and progress of traceability measures at suppliers;
- Communicating the conflict minerals policy and sourcing expectations to new suppliers;
- Incorporating conflict minerals compliance into supplier audits;
- Retaining a third-party IT vendor to assist with supplier outreach and/or data analysis;
- Reaching out to smelters and refiners to encourage them to undergo audits; and
- Joining the CFSI and participating in other industry initiatives.

The items listed were in part a function of the OECD guidance elements already in place or other work that already had been done, with issuers that were further along typically listing fewer areas for future improvement. Issuers also did not necessarily list all of their planned areas of improvement. Many issuers were conservative in describing prospective risk mitigation efforts and other areas of improvement in their compliance programs, not listing everything that they plan to do, since the ability to successfully implement at least some program elements is dependent on supplier cooperation.

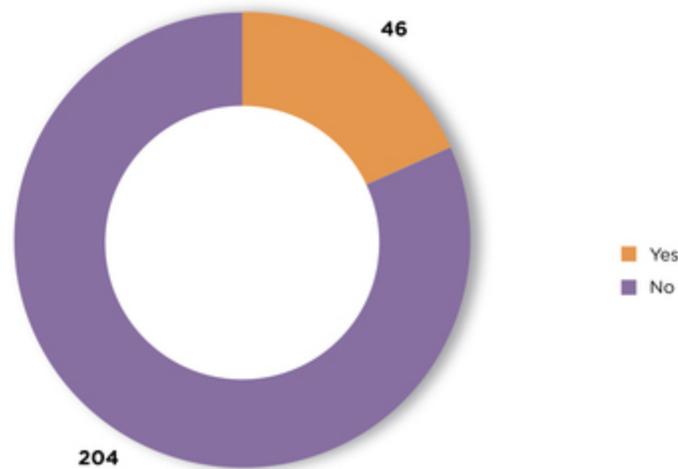
CFSI Membership

Fourteen percent of the sample group indicated that they were members of the CFSI. Step 4 of the OECD guidance contemplates independent third-party audits of supply chain due diligence at identified points in the supply chain. Issuers satisfy this element of the OECD guidance through multistakeholder initiatives such as the CFSI, since it is not practical to do so on an individual basis. The CFSI is of the view that companies should be CFSI members in order to rely on the CFSI's programs to satisfy this element of the OECD guidance and that usage of publicly available CFSI smelter and refiner information without CFSI membership does not satisfy Step 4 of the OECD guidance.

Smelter and Refiner Information

Most of the sample group did not include smelter or refiner information in their filings. Only 46, or 18 percent, of the sample group issuers provided smelter or refiner information.

Chart 16: Discussion of Smelter or Refiner Information — Sample Group



All of the sample group issuers that provided smelter or refiner information did so in their CMRs; none of the Form SD-only filers provided smelter or refiner information. As a percentage of the sample group CMR filers, 22 percent provided smelter or refiner information. A significant number of the issuers that did not include smelter or refiner information indicated that they were not able to determine the smelters or refiners in their supply chains.

A large portion of the sample group issuers that included smelter or refiner information in their CMRs came from the electronics industry. This was not surprising, since issuers in that industry generally are further along in mapping their supply chains. The issuers in the sample group that included smelter or refiner information also skewed towards larger companies.

There was significant variation in how the sample group reported smelter and refiner information:

- Slightly more than half of the sample group subset (54 percent) appear to have listed all of the smelters and refiners identified to them by their suppliers, or at least all that were on the Standard Smelter Names tab of the template.
- Five issuers only listed smelters and refiners that were certified as conflict-free.
- Three issuers only listed smelters and refiners that sourced from the Democratic Republic of the Congo ("DRC") region.

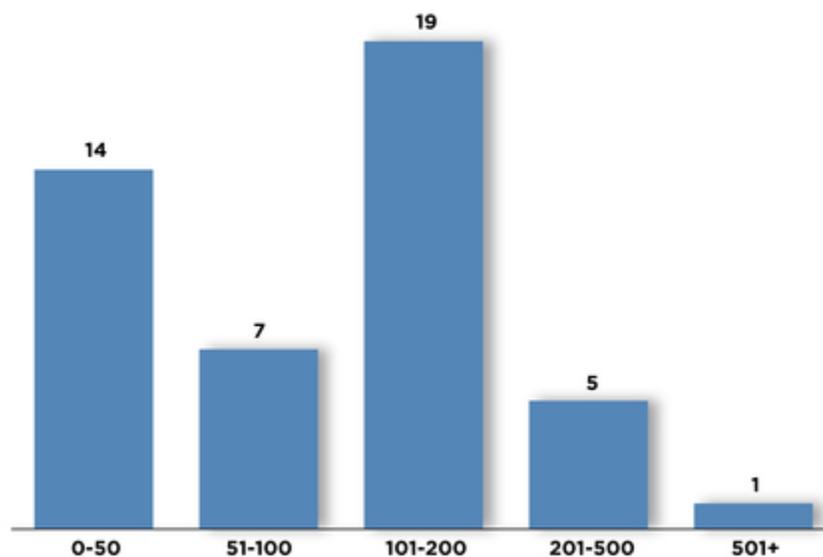
- Thirteen issuers did not list individual smelters or refiners, but instead provided smelter and refiner information on an aggregated basis.

Issuers generally did not indicate whether the smelters and refiners reported were affirmatively determined to be part of the issuer's supply chain, or were merely reported to the issuer by its suppliers.

Number of Smelters and Refiners Disclosed

The number of smelters and refiners listed or indicated by the sample group subset that reported smelter or refiner information varied widely.

Chart 17: Number of Smelters and Refiners Disclosed — Sample Group



Country of Origin Information

Approximately two-thirds (30) of the 46 sample group issuers that included smelter or refiner data also provided country of origin information. Sixteen of these issuers listed specific individual countries of origin, while the remainder primarily used the L1, L2 and L3 country groupings.

Certification Information

Many of the issuers that provided smelter or refiner information also indicated the certification status of the smelters and refiners. Some of these issuers also provided additional detail regarding the certification, including the date as of which the certification information was current, the entity that certified the smelter or refiner and whether the smelter or refiner was "active" and what that meant.

Use of "Labels"; Product Descriptions

Eighty percent of the sample group that filed CMRs described products as "DRC conflict undeterminable" or used equivalent language, notwithstanding the SEC's April 29, 2014, statement, which indicated that issuers are not required to describe products as "DRC conflict undeterminable," "DRC conflict free" or having "not been found to be DRC conflict free."

A small number of issuers outside the sample group misapplied the conflict minerals rule, describing products as "DRC conflict free" in their CMRs but not obtaining an IPSA. In both its April 29, 2014, statement and an earlier FAQ, the SEC indicated that, if an issuer describes a product as "DRC conflict free" in its CMR, an IPSA is required.

Issuers generally provided high-level descriptions of their in-scope product categories, often based on their Form 10-K disclosure. In some cases, issuers instead indicated that all of their products were in-scope, without including a description of their products.

Filing Signatory and Designated Contact Person

The Form SD is required to be signed by an "executive officer," as that term is defined in Rule 3b-7 under the Exchange Act. The issuer also is required to indicate a contact person on the cover page of the Form SD.

We did not review these items across the entire sample group, since decisions relating to these items were, and are expected to continue to be, largely determined by the specific managerial responsibilities of relevant issuer personnel and the issuer's practice with respect to other Exchange Act filings. However, we share below some observations from our client base in this area.

Given the technical signature requirement of Form SD, issuers had a limited number of signatories to choose from. In most cases, Form SDs of our client issuers were signed by either the chief financial officer or general counsel, in roughly equal proportion. In a substantially smaller percentage of cases, the chief executive officer or a manufacturing or supply chain executive signed the Form SD. At many of our clients, especially larger companies, manufacturing and supply chain personnel were not considered to be executive officers within the meaning of Rule 3b-7 and were therefore not eligible to sign the Form SD. In some cases, general counsel also were ineligible.

A significant percentage of our client issuers, especially larger companies, listed someone other than the signatory as the contact person. Typically, the contact person was someone who regularly interacts with external constituencies with respect to the issuer's filings or who has direct oversight or significant day-to-day involvement with the conflict minerals compliance program.

Location of Website Disclosure

The conflict minerals rule requires an issuer to disclose certain information regarding its RCOI, as well as its CMR, on its website. Placement was and is expected to continue to primarily be driven by an issuer's overall website layout and content, so we also did not examine this item as part of our sample group review.

However, we note that, across our issuer client base, this information was most commonly included in

the investor relations section of the website with the issuer's other SEC filings. To a lesser extent, issuers with separate corporate social responsibility ("CSR") sections on their websites (which tended to be larger companies) included this information in that section or provided a link within the CSR section to the investor relations page where the information was located.