

DR Advisor Alert

October 2012

SEC Adopts Final Disclosure Rule for Use of Conflict Minerals

Introduction

On August 22, 2012, the U.S. Securities and Exchange Commission (SEC) adopted a final rule (pursuant to Release No. 34-67716)¹ for the public disclosure of the use of conflict minerals (“conflict minerals rule”). The conflict minerals rule applies to all companies, including foreign private issuers, that:

- file reports with the SEC under the Securities Exchange Act of 1934 (Exchange Act); and
- manufacture or contract to manufacture products for which conflict minerals “are necessary to the functionality or production” of the product.

These issuers must file (on Form SD, a newly-created form) a specialized disclosure report for each calendar year, beginning with 2013. Each report is due on May 31 of the year following the calendar year covered by the report. Thus the first Form SD (covering the 2013 calendar year) must be filed by May 31, 2014.

The SEC classifies as conflict minerals only cassiterite (tin), columbite-tantalite (tantalum), gold and wolframite (tungsten) and their derivatives, unless the U.S. Secretary of State later determines that additional minerals and their derivatives are also financing armed conflict in the Democratic Republic of the Congo or adjoining countries (collectively known as “Covered Countries” or “DRC Countries”). Generally, these minerals are raw materials for producing a wide range of products, such as metal alloys and solders, wires, electronic circuits and components, and jewelry.

On page 33 of the SEC’s rule release is a flowchart to help companies determine whether they are subject to the conflict mineral disclosure rule and, if so, what their disclosure obligations are thereunder.

Determining if a company is contracting to manufacture a product

In determining whether a company is “contracting to manufacture” a product for which conflict minerals are necessary to the product’s functionality or production, the test is whether the company has some actual influence over the production by a third party. Under guidance provided in the SEC’s rule release, a company is not deemed to have influence over a product’s manufacture if it merely:

- specifies or negotiates contractual terms with a manufacturer that do not directly relate to the manufacturing of the product;
- affixes its brand, marks, logo, or label to a generic product manufactured by a third party; or
- services, maintains, or repairs a product manufactured by a third party.

A company is also considered to be “contracting to manufacture” a product if it contracts for the manufacture of a component of the product.

¹ The rule (<http://www.sec.gov/rules/final/2012/34-67716.pdf>) was adopted under Section 13(p) of Securities Exchange Act of 1934 which was enacted pursuant to Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Determining if a conflict mineral is necessary to the functionality or production of a product

The conflict minerals rule does not define when a conflict mineral is necessary to the functionality or production of a product. However the SEC's rule release provides guidance on the factors a company should consider in making such a determination.

With regard to functionality, the relevant factors are:

- whether a conflict mineral is contained in and intentionally added to the product or a component of the product, rather than being a naturally-occurring by-product;
- whether a conflict mineral is necessary to the product's generally expected function, use, or purpose; and
- if a conflict mineral is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration.

With regard to a conflict mineral being necessary to the production of a product, the relevant factors are:

- whether a conflict mineral is contained in the product and intentionally added in the production process for the product or any component of the product; and
- whether the conflict mineral is necessary to produce the product.

Determining if conflict minerals originated in covered countries

If conflict minerals are necessary to the functionality or production of a product that is either manufactured or contracted to be manufactured by a company that is a reporting issuer under the Exchange Act, the company must conduct a good faith, reasonable country-of-origin inquiry to determine if these minerals originated in covered (DRC) countries or are from scrap or recycled sources.

If the inquiry determines that the company's conflict minerals did not originate in a covered country or did come from scrap or recycled sources, or if the company has no reason to believe that the minerals may have originated in covered countries or reasonably believes that the minerals did come from scrap or recycled sources, the company must:

- disclose on Form SD its determination;
- provide a brief description of the country of origin inquiry and its results; and
- make this description publicly available on the company's website and include in the Form SD a link to the website.

If the country of origin inquiry determines that the company knows or has reason to believe that its conflict minerals may have originated in covered (DRC) countries and that the company knows or has reason to believe that the minerals may not be from scrap or recycled sources, the company must undertake due diligence on the source and chain of custody of its conflict minerals. If the company determines based on its due diligence that its conflict minerals did not originate in a covered country, or that the conflict minerals came from recycled or scrap sources, it must disclose that determination on Form SD and briefly describe the reasonable country of origin inquiry and the due diligence efforts conducted by the company. This information must also be made available on the company's website, with a link to the website being included in the Form SD. If the company is unable to make either such determination, it must:

- file a Conflict Minerals Report as an exhibit to its Form SD;
- make this report publicly available on its website and include a link to the website in the Form SD; and
- provide an audit report as described below.

The Conflict Minerals Report must include a description of the measures the company took to exercise due diligence on the source and chain of custody of its conflict minerals. Additional information is required if the company's products are not "DRC conflict free" as discussed below.



Due diligence requirements

A company that has determined it must undertake due diligence on the source and chain of custody of its conflict minerals must employ measures that conform to a nationally or internationally recognized due diligence framework, such as the due diligence guidance approved by the OECD².

Information and audit requirements for a Conflict Minerals Report

Products found to be “DRC conflict free”

If a company determines that the conflict minerals necessary for the manufacture of its products – or for products it has contracted to manufacture – originate from covered (DRC) countries but did not directly or indirectly finance or benefit armed groups in those countries (i.e., are “conflict-free”), the company is subject to the following audit and certification requirements:

- obtain an independent private sector audit of its Conflict Minerals Report covering the due diligence measures performed by the company and the design of the company’s due diligence framework;
- certify that it obtained such an audit and include the audit report in its Conflict Minerals Report; and
- identify the auditor.

Products not found to be “DRC conflict free”

If a company determines that the products it manufactures – or products it has contracted to manufacture – are not “DRC conflict free”, the company must, in addition to the above audit and certification requirements, describe the following in its Conflict Minerals Report:

- products manufactured, or contracted to be manufactured, that have not been found to be “DRC conflict free”;
- facilities used to process the conflict minerals in those products;
- country of origin of these conflict minerals; and
- efforts to determine, with the greatest possible specificity, the mine or location of origin of such conflict minerals.

Unable to determine if products are “DRC conflict free”

If a company is unable to determine, after exercising due diligence on the source and chain of custody of its conflict minerals, whether the conflict minerals necessary for the manufacture its products – or for products it has contracted to manufacture – originated in covered (DRC) countries, or financed or benefited armed groups in those countries, or came from recycled or scrap sources, then those products are permitted to be described as “DRC conflict undeterminable” for a temporary transition period covering the first two years in which reporting is required (four years for smaller reporting companies). In such a case, a company must describe the following in its Conflict Minerals Report:

- products that are “DRC conflict undeterminable”;
- the due diligence measures undertaken by the company;
- the country of origin of the conflict minerals, if known;
- facilities used to process the necessary conflict minerals in those products, if known;
- efforts to determine, with the greatest possible specificity, the mine or location of origin of the conflict minerals; and
- any steps taken or to be taken since the end of the period covered in the most recent Conflict Minerals Report to mitigate the risk that the company’s necessary conflict minerals finance and benefit armed groups in covered (DRC) countries, including any steps to improve due diligence.

A company is not required to obtain an independent private sector audit of its Conflict Minerals Report if the necessary conflict minerals for its products are classified as “DRC conflict undeterminable.”

² www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/46740847.pdf



Products made from conflict minerals derived from recycled or scrap sources

Products that a company manufactures - or has contracted to manufacture - using conflict minerals derived from recycled or scrap sources (rather than from mined sources) are classified as "DRC conflict free." The determination whether conflict minerals come from recycled or scrap sources involves two steps. If the reasonable country of origin inquiry results in a good faith belief that conflict minerals come from recycled or scrap sources, this is disclosed in Form SD and no further inquiry is necessary. However if a company cannot establish such good faith belief, it must then conduct further diligence to determine whether the conflict minerals come from recycled or scrap sources.

In the case of gold (one of the four minerals classified as conflict minerals) such further due diligence must be conducted in accordance with the OECD due diligence framework for gold, and the company must obtain an audit of its Conflict Minerals Report. In its conflict minerals rule release, the SEC notes that, "A gold supplement³ to the OECD's due diligence guidance... is presently the only nationally or internationally recognized due diligence framework for any conflict mineral from recycled or scrap sources of which we are aware."

With respect to the other conflict minerals (cassiterite, columbite-tantalite and wolframite), no nationally or internationally recognized due diligence framework currently exists. Therefore the due diligence must be conducted without the use of a framework. However, if a framework is subsequently developed for these minerals, companies will be required to use it.

If a company cannot reasonably conclude after its due diligence inquiry that its conflict minerals are derived from recycled or scrap sources, the company must file a Conflict Minerals Report and describe the due diligence measures that it undertook in making this determination. However, an independent private sector audit regarding such due diligence measures is not required for minerals other than gold, unless a nationally or internationally recognized due diligence framework is developed for such minerals.

For more information, please contact your J.P. Morgan Depositary Receipt Group representative.

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³ www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/FINAL%20Supplement%20on%20Gold.pdf

