A Review of the First Wave of Conflict Mineral Filings

July 30, 2014

Over the past 18 months companies have scoured their supply chains and wrestled with hard-to-interpret regulatory mandates in order to comply with the initial reporting deadline for the SEC's new conflict minerals rule. As a result, investors and the general public have unprecedented insight into the presence and source of conflict minerals in the supply chains of SEC-reporting companies. But many details remain unclear—Davis Polk's survey shows that most companies are unable (or unwilling) to confirm whether or not their conflict minerals originated in the Democratic Republic of Congo or a neighboring country, or whether proceeds from these minerals actually financed armed conflict. While companies are looking to OECD guidance on how to analyze their supply chains, their efforts to reach out to suppliers varied. The overall picture from the first wave of filings was undoubtedly blurred by late-breaking developments stemming from the ongoing legal challenge to the new rule.

In August 2012, the U.S. Securities and Exchange Commission adopted a rule to implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, requiring each SEC-reporting company to provide disclosure about conflict minerals that are "necessary to the functionality or production" of any product manufactured or contracted for manufacture by the company.[1] Conflict minerals include gold, tantalum, tin and tungsten (the so-called 3TG minerals) and other minerals determined by the U.S. government to be financing conflict in the Democratic Republic of Congo (DRC) or its neighboring countries, called the "covered countries."

Conflict mineral disclosures are presented in a new form, Form SD (for "specialized disclosure"), filed by May 31 for the prior calendar year. Under the rule as adopted, a company whose products contain conflict minerals that may have originated in the covered countries would have been required to categorize those products in one of three buckets:

- products that *have not been found to be DRC conflict free*,
- products that are *DRC conflict undeterminable* and
- products that are *DRC conflict free.*

A company that is able to say that its products are "DRC conflict free" would convey to the public that its products do not contain conflict minerals that financed armed groups in the covered countries, while a company that categorizes its products as "not having been found to be DRC conflict free" would convey the opposite message—and in addition, would be required to describe those products in its filing. The middle category, "DRC conflict undeterminable," was fashioned by the SEC as a temporary accommodation, available through the 2014 reporting year for larger companies and the 2016 reporting year for smaller companies.

[1] See Davis Polk Client Memorandum, *Implementing the SEC's Final Conflict Mineral Rules: Guidelines and Commonly Asked Questions* (Oct. 26, 2012, updated Apr. 17, 2014) (available at http://www.davispolk.com/download.php?file=sites/default/files/files/Publication/e101d718-e566-4c0f-9fa0-ac7fffe63e53/Preview/PublicationAttachment/34950352-c0bd-4a9a-afd5-b3694333fc9b/10.26.12_Implementing.pdf).

A few weeks before the initial Form SD deadline, the U.S. Court of Appeals for the D.C. Circuit struck down the provision that would have required some companies to describe their products as "not having been found to be DRC conflict free," finding it in contravention of the free-speech guarantee of the First Amendment to the U.S. Constitution. According to the court, "The label 'conflict free' is a metaphor that conveys moral responsibility for the Congo war. It requires an issuer to tell consumers that its products are ethically tainted, even if they only indirectly finance armed groups. . . . By compelling an issuer to confess blood on its hands, the statute interferes with that exercise of the freedom of speech under the First Amendment." [2]

The court and the SEC subsequently rebuffed requests by business and trade groups to stay the rule in its entirety. Instead, the SEC stayed only the provisions requiring a company to label its products "DRC conflict free," "DRC conflict undeterminable" or "not having been found to be DRC conflict free," and advised that companies should otherwise comply with the rule.[3] Two members of the SEC protested, arguing that the rule should have been stayed entirely because a report lacking a conclusion about whether a company's conflict minerals may have financed armed conflict rendered the rule pointless. According to Commissioners Gallagher and Piwowar, "it is the listing of products—the apotheosis of the diligence process—that is central to the rule."[4]

Overview of the Rule

The SEC outlined a three-stage process for complying with the conflict minerals rule. In Stage 1, a company must make a threshold determination: does the company manufacture or contract to manufacture products for which conflict minerals are necessary to functionality or production? If the answer to this gating question is no, the company need not file a Form SD. Many companies struggled with this gating question in the months after the rule was adopted. In May 2013, the SEC staff published guidance that settled several open issues and allowed many companies to conclude that they simply were not subject to the rule.[5]

Once a company concludes that it must file a Form SD because it manufactures or contracts to manufacture products with necessary conflict minerals, the company must proceed to Stage 2 and undertake a "reasonable country of origin inquiry" into the source of its conflict minerals. If after this "RCOI" the company concludes that:

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[2] *National Association of Manufacturers, et al., v. Securities and Exchange Commission, et al.,* 748 F.3d 359 (D.C. Cir. 2014). See Davis Polk Client Newsflash, *D.C. Circuit Court Partially Invalidates Conflict Minerals Rule* (Apr. 14, 2014) (available at **http://www.davispolk.com/dc-circuit-court-partially-invalidates-conflict-minerals-rule/**).

[3] SEC, *Order Issuing Stay in the Matter of Exchange Act Rule 13p-1 and Form SD*, Rel. No. 34-72079 (May 2, 2014) (available at **http://www.sec.gov/rules/other/2014/34-72079.pdf**); SEC, *Statement on the Effect of the Recent Court of Appeals Decision on the Conflict Minerals Rule* (Statement of Keith F. Higgins, Director, SEC Division of Corporation Finance) (Apr. 29, 2014) (available at **http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370541681994#.U9FXGKPD_ct**). See Davis Polk Client Newsflash, *SEC (Mostly) Forges Ahead on Conflict Minerals* (Apr. 29, 2014) (available at **http://www.davispolk.com/sec-mostly-forges-ahead-conflict-minerals/**).

[4] SEC, *Joint Statement on the Conflict Minerals Decision* (Statement of Commissioners Daniel M. Gallagher and Michael S. Piwowar) (Apr. 28, 2014) (available at **http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370541665582#.U9FWIqPD_cs**).

[5] SEC, *Dodd-Frank Wall Street Reform and Consumer Protection Act*, *Frequently Asked Questions*, *Conflict Minerals* (May 30, 2013) (available at **http://www.sec.gov/divisions/corpfin/guidance/conflictminerals-faq.htm**). See Davis Polk Client Newsflash, *SEC Issues Guidance on Conflict Minerals* (May 31, 2013) (available at **http://www.davispolk.com/download.php?file=sites/default/files/files/Publication/c42cfe2b-9b9d-462c-9748-096ea0317837/Preview/PublicationAttachment/8c263b34-944d-406a-be36-0c29a4e26e3b/053113_conflict_mineral.html**).

- it has no reason to believe that its conflict minerals may have originated in the covered countries or
- it reasonably believes that its conflict minerals came from recycled or scrap sources,

the company has substantially discharged its obligations under the rule and need only briefly describe the RCOI process and results in its Form SD and post this information on its website.

On the other hand, if after the RCOI the company has reason to believe that its conflict minerals may have originated in the covered countries and are not from recycled or scrap sources, the company must proceed to Stage 3, in which it "must exercise due diligence on the source and chain of custody of its conflict mineral[s]." Unless the results of this post-RCOI due diligence show that the company's conflict minerals did not come from the covered countries (or that they came from recycled or scrap sources), the company must file a Conflict Minerals Report and post it on its website—even if its due diligence confirms that its conflict minerals did not finance armed groups and that they are in fact "DRC conflict free."

The Conflict Minerals Report is filed as a separate exhibit to Form SD and is to be accompanied by an independent audit report, although the SEC excused companies from the independent audit requirement if they have any products that are "DRC conflict undeterminable" during the temporary transition period in which that label is permitted. The objective of the audit of the Conflict Minerals Report is for the auditor to express an opinion on whether the design of the company's due diligence measures conformed to the criteria set forth in the "nationally or internationally recognized due diligence framework" used by the company, and whether the company's description of its due diligence in its Conflict Minerals Report is consistent with the due diligence the company actually performed.

As discussed above, under the rule as originally adopted by the SEC, the company must describe its products in its Conflict Minerals Report as either "DRC conflict free" or having "not been found to be DRC conflict free," or, during the temporary transition period, "DRC conflict undeterminable," if the company was unable to determine the origin of its conflict minerals or was unable to determine whether its conflict minerals financed armed groups in the covered countries. For products that do not merit the "DRC conflict free" label, the company's Conflict Minerals Report must describe the facilities used to process its conflict minerals, the country of origin of the conflict minerals and the company's efforts to determine the mine or location of origin "with the greatest possible specificity." Although the SEC responded to the court ruling by excusing companies from labeling their products one way or another, the SEC emphasized that the Conflict Minerals Report should include this information for products that were not found to be "DRC conflict free." Therefore, while use of the SEC-prescribed labels would not be necessary, the required disclosures could indicate that a company was unable to conclude that its products were "DRC conflict free."

Our Survey

The first Form SD was filed on April 24, 2014 by a Taiwanese semiconductor company, and by the time the initial Form SD deadline had passed some 1,300 companies had filed—substantially fewer than the 6,000 or so the SEC originally estimated would be covered by the rule.[6] We reviewed a sample from the first wave of Form SD filings to see how companies have begun to interpret their obligations under the new rule, as modified by the late-breaking court decision and the SEC's response to it.

[6] SEC, *Final Rule: Conflict Minerals*, Rel. No. 34-67716 (Aug. 22, 2012) [77 FR 56273] at p. 249.

We focused our review on companies in the S&P 500, an index of large-cap U.S. companies, and companies in the S&P Midcap 400, an index of mid-cap mostly U.S. companies. We also collected data on non-U.S., SEC-reporting companies in the S&P Global 1200, an index of global large-cap companies.[7]

We reviewed companies in ten industries (as assigned by S&P):

- consumer discretionary
- consumer staples
- energy
- financials
- healthcare
- industrials
- information technology
- materials
- telecommunication services
- utilities

As an initial matter, we looked at how many companies in each industry in the S&P 500 and S&P 400, and how many non-U.S., SEC-reporting companies in each industry in the S&P 1200, filed a Form SD by the 2014 deadline. For a deeper dive into the U.S. reporting company filings, we reviewed a sample of approximately 100 S&P 500 filings and 100 S&P 400 filings, examining a number of companies per industry proportionate to the industry's overall representation in its respective index, starting with those companies with the largest market capitalizations as of May 31, 2014.

Number of Filings and Industry Impact

By the 2014 deadline:

- in the S&P 500, 212 companies, or 42%, filed a Form SD,
- in the S&P 400, 157 companies, or 39%, filed a Form SD and
- in the S&P 1200, 71 non-U.S., SEC-reporting companies, or 37%, filed a Form SD.

It may be surprising that mid-cap and non-U.S. companies' filing rates are roughly equivalent to the filing rate for large-cap companies. This may reflect the attention the conflict minerals rule has received since its adoption, prompting companies of all sizes to engage in compliance efforts in advance of the filing deadline. Nevertheless, the total number of filers is only about one-fifth of what the SEC originally expected. It is difficult to know whether the SEC simply overestimated the cohort of likely filers, whether some companies took aggressive approaches in concluding that they were not covered by the rule or, as some commentators have suggested, whether some companies that were required to file simply chose not to.[8] We think deliberate non-compliance is unlikely. Two interpretive questions preoccupied companies in Stage 1 of the process: determining whether conflict minerals are "necessary" to their products, and determining whether a product sourced from a third-party manufacturer was a product that had been "contracted" for manufacture. It is possible that some companies interpreted these tests more narrowly than the SEC anticipated, and thereby placed themselves beyond the rule's reach.

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[7] S&P 500, S&P Dow Jones Indices (available at **http://us.spindices.com/indices/equity/sp-500**); S&P 400, S&P Dow Jones Indices (available at **http://us.spindices.com/indices/equity/sp-400**); S&P 1200, S&P Dow Jones Indices (available at **http://us.spindices.com/indices/equity/sp-global-1200**). All references to the S&P 500, S&P 400 and S&P 1200 refer to the indices as of May 31, 2014.

[8] Wilczek, Yin, *In Conflict Mineral Disclosures, Different Industries Seeing Different Trends, Corp. Law & Accountability Rep.,* BLOOMBERG DNA (Jun. 27, 2014) (citing speakers participating in a panel regarding SEC reporting) (available at **http://www.bna.com/conflict-mineral-disclosures-n17179891637/**); TheCorporateCounsel.net, *Inside Track with Broc: Lawrence Heim on How 1st Batch of Form SDs Look* (Jul. 9, 2014) (available at **http://www.thecorporatecounsel.net/Member/InsideTrack/2014/07_09_Heim.htm**).

In each of the S&P 500 and S&P 400, the materials, information technology, industrials and healthcare industries showed the highest filing rates, ranging from 56% (healthcare, S&P 500 and information technology, S&P 400) to 80% (materials, S&P 500), while financials, utilities and telecommunication services exhibited the lowest filing rates, ranging from zero percent (telecommunication services, S&P 400) to 20% (which reflects just one telecommunication services filer in the S&P 500). These results are not surprising, particularly in light of the SEC staff's May 2013 guidance that service providers are not covered by the rule, even if they manufacture products with conflict minerals that are used to deliver their services. In the S&P 1200, the consumer discretionary and consumer staples industries were more heavily represented among non-U.S., SEC-reporting companies than was the materials industry.

About half of the consumer discretionary companies in each of the three indices filed a Form SD. Among consumer staples companies, the results varied substantially: 14% of S&P 400 companies in this industry filed a Form SD, compared to 30% in the S&P 500 and 50% of the non-U.S., SEC-reporting companies in the S&P 1200. This could be a function of differences in business complexity among the companies in the three indices, although many U.S. consumer staples companies, small and large, were able to conclude that they were not covered by the rule when the SEC staff confirmed that product packaging, such as a tin can, was not itself a "product" for purposes of the rule.

Length, Content and Signatory

Although we found our samples from the S&P 500 and S&P 400 similar in many respects, the S&P 500 filings were both longer and contained more components, presumably attributable to differences in business scope and complexity in the companies making up the two indices.

The overwhelming majority of filings surveyed, 87% of S&P 500 filers and 78% of S&P 400 filers, included a Conflict Minerals Report, revealing somewhat less of an ability to avoid full-scale due diligence based on the RCOI than originally assumed by the SEC, who expected 75% of filers to move to the due diligence stage.

Only two companies surveyed—one each in the S&P 400 and S&P 500, but two more than many observers expected—included an independent audit report. Currently, an independent audit is only required if the company makes an explicit determination that its products are "DRC conflict free."

The average length of a company's Form SD, not including its Conflict Minerals Report, was 3.5 pages for the S&P 500 and 3.3 pages for the S&P 400. Conflict Minerals Reports were longer, averaging 5.7 pages for the S&P 500 and 4.8 pages for the S&P 400. Most companies, 78% of the S&P 500 and 76% of the S&P 400, provided background and descriptive information about themselves in their filings, even though this is not required by the form.

Form SD is required to be signed by an "executive officer," a term with a specific meaning and consequences under the Securities Exchange Act of 1934. We found some differences in signatory between the S&P 400 and S&P 500, undoubtedly reflective of the larger and more specialized managerial ranks at S&P 500 companies, but perhaps also reflecting more ownership of conflict mineral issues at the operational level. For the S&P 400, the vast majority of signatories—over 90%—were either legal (54%) or finance (38%) executives. Signatories for the S&P 500 included fewer legal and finance executives, 33% and 40%, respectively, and also included 27% with such titles as:

- Group Vice President, Global Purchasing
- Vice President, Global Purchasing and Supply Chain
- Executive Vice President and Chief Supply Chain Officer
- Senior Vice President, Quality and Operations
- Group President, Global Quality and Operations

- Executive Vice President, Chief Sustainability Officer and Chief Information Officer
- Chief Customer Officer

RCOI and Due Diligence

One feature of Form SD that some companies seemed to find unclear is the difference between the "reasonable country of origin inquiry" regarding conflict minerals, or "RCOI," and "due diligence on the source and chain of custody" of conflict minerals. The rule contemplates two separate processes. The RCOI, carried out in Stage 2, is intended to be flexible and adaptable, and the SEC did not provide prescriptive guidelines for the process. Instead, the SEC explained that what constitutes a "reasonable" inquiry can differ "based on the issuer's size, products, relationships with suppliers, or other factors" and that facts and circumstances will guide this determination. Due diligence, on the other hand, is carried out in Stage 3, only after the company is unable to determine that its conflict minerals did not originate in the covered countries (or did not come from recycled or scrap sources). Diligence is more onerous and is required to be executed in accordance with a "nationally or internationally recognized due diligence framework." Virtually all companies surveyed that conducted due diligence indicated that they used the framework created by the Organisation for Economic Co-operation and Development (OECD), which is unremarkable given the SEC's observation that it was the only recognized framework available at the time the rule was adopted. While the SEC stated that the RCOI is "consistent with the supplier engagement approach in the OECD guidance," the SEC did not require companies to use this or any particular framework for RCOI purposes.

Although Form SD contemplates two separate processes for RCOI and due diligence, we found significant overlap between the two in how companies approached and described their compliance efforts. For a company that is required to conduct due diligence and file a Conflict Minerals Report, no description of the RCOI is required in Form SD. Nevertheless, companies that filed a Conflict Minerals Report frequently discussed their RCOI as if it were a part of the due diligence process.

The OECD framework is intended for "all companies in the mineral supply chain that supply or use tin, tantalum, tungsten and their ores or mineral derivatives and gold sourced from conflict-affected or high risk areas."[9] The framework consists of five steps:

1. Establish strong company management systems,
2. Identify and assess risk in the supply chain,
3. Design and implement a strategy to respond to risk,
4. Independent third-party audit of smelter/refiner's due diligence practices and
5. Report annually on supply-chain due diligence.

Approximately half of the companies that conducted due diligence described their due diligence efforts explicitly within the context of the OECD's five-step framework, in many cases closely adhering to the recommendations in the OECD guidance.

The first step calls for the establishment of strong company management systems. In this step, we saw many companies describe activities discussed in the framework, including the establishment of conflict

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[9] OECD, *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: Second Edition* at p. 15 (available at **http://www.oecd.org/daf/inv/mne/GuidanceEdition2.pdf**).

mineral policies, grievance mechanisms, and a strong internal management infrastructure to support supply-chain due diligence. Over three-quarters of the surveyed companies disclosed information about their conflict mineral policies, though only a handful included the complete text of the policy in their filing.

The second step in the OECD's due diligence framework calls for identifying and assessing risk in a company's supply chain. Most of the companies surveyed are downstream users of conflict minerals that do not source directly from mines, smelters or refiners and are several layers removed from these upstream supply-chain participants. The OECD framework provides specific guidance for downstream companies, calling on them to "identify, to the best of their efforts, and review the due diligence process of the smelters/refiners in their supply chain and assess whether they adhere to due diligence measures" put forward in the guidance. Companies that were required to exercise due diligence, and that were not required to describe their RCOI, nevertheless often tended to discuss their RCOI in the context of the second step of the OECD due diligence framework. Several companies explicitly stated that they viewed the same efforts as satisfying both the RCOI and due diligence requirements, or that they approached the RCOI so as to ensure that it satisfied at least some of the due diligence requirements they might later be required to undertake.

The third step, designing and implementing a strategy to respond to identified risks, often included descriptions of the company's process for reporting on its conflict mineral efforts and escalating concerns; designing a strategy for risk remediation; and forming dedicated task forces, governance committees or other groups. A handful of companies also included communications with their board of directors as part of their conflict minerals compliance efforts. Some companies described these activities within the first step of the OECD framework and others within the third step.

The fourth step, an independent third-party audit of supply-chain due diligence, was not undertaken by any surveyed company; while the audit envisioned by the OECD is different from the audit envisioned by the conflict minerals rule, many companies explicitly stated that they do not have direct relationships with smelters and refiners and do not perform direct audits of these entities. Finally, most companies considered the fifth step in the OECD framework, reporting on supply-chain due diligence, to be satisfied—indeed, some explicitly stated as much—by virtue of their conflict mineral filings and required website postings.

Supplier Scoping and Outreach

Prior to engaging with suppliers, companies generally determined what part of their business was "in-scope," or within the scope of the conflict minerals rule. Companies approached the determination in different ways. Most commonly, companies determined that certain products (or their components) were in-scope, and narrowed their focus to suppliers of inputs for those products. Other companies determined that certain business lines or segments were in-scope, and focused their supplier outreach accordingly. Some did both. Less frequently, companies turned the question around and focused on those suppliers that were likely to provide 3TG components or products, and considered those in-scope for their inquiries.

Companies most often indicated that they surveyed all suppliers determined to be in-scope. The number of suppliers contacted under this approach varied based upon the breadth of the company's products and supply chain: at least one company reported a single in-scope supplier while others had tens of thousands.

A minority of companies acknowledged adopting an approach in which they narrowed the breadth of their outreach either to a subset of suppliers or a subset of in-scope suppliers, based upon some quantitative threshold. When following this type of approach, companies most commonly determined the subset of suppliers to survey based upon a numerical threshold related to expenditures. For example, one company focused on "suppliers that [it] understood to have 3TG in their products with annual purchase volume greater than $3 million," while another surveyed first-tier suppliers that "represented approximately 80% of the [c]ompany's [annual purchase value] of direct components."

Other companies reached out only to their "major" or "largest" suppliers, or a "representative sample"; some companies defined these terms with metrics, but most omitted details. Less common approaches included a two-tier approach, with at least one company capturing both any supplier that had reported the existence of a conflict mineral in an international database and also suppliers that made up 80% of the company's direct component expenditures.

A number of companies described their supplier outreach as "risk-based," although the actual approaches varied, and included the methods described above, without apparent targeting of suppliers suspected most likely to be supplying conflict minerals sourced from the covered countries.

Most companies solicited information from suppliers with a survey based upon the Conflict Minerals Reporting Template developed by the Electronic Industry Citizenship Coalition (EICC) and the Global e-Sustainability Initiative.[10] In addition to sending the survey, many companies provided their suppliers with background information about the conflict minerals rule, the company's sourcing policy, training materials or other informational resources, in order to facilitate supplier responsiveness.

Most companies indicated that they followed up with suppliers who were unresponsive, who provided incomplete information or whose responses otherwise raised red flags. Follow-up efforts varied. Many companies sent emails or mailings. Others had company personnel reach out to suppliers by telephone. A limited number of companies made on-site visits and at least one company undertook an engineering evaluation.

Many filers provided quantitative information related to supply-chain outreach and responsiveness. Some companies provided very specific information such as the number or percentage of suppliers surveyed, the number or percentage of responsive suppliers and the number of suppliers that the company engaged with for follow-up. Other companies provided only one or two pieces of this information. Some companies undoubtedly included this information where they believed it reflected favorably on their RCOI or due diligence efforts, although this was not always the case—a number of companies included rather low supplier response rates in their disclosures. For purposes of the RCOI at least, the SEC stated that a company does not need to receive representations from all of its suppliers or even hear back from all of the suppliers it contacted in order to conclude that its conflict minerals did not originate in the covered countries.

A small but significant number, 17% of S&P 500 and 14% of S&P 400 companies surveyed, disclosed that they used third-party assistance to comply with the conflict minerals rule. The services provided by third parties varied, though frequently they included assisting in data collection, facilitating supplier outreach efforts, tracking and analyzing supplier responses, and, in a few cases, administering the entire RCOI and due diligence processes.

Product Characterization

In the wake of the D.C. Circuit Court's decision and the SEC's subsequent stay of the labeling requirement, companies were left to decide how, if at all, to characterize their products in their Conflict Mineral Reports. Our survey confirmed the widespread expectation that most companies would not report that their purchasing activity did not support armed conflict. [11] In some cases this may have been because

[10] CFSI, *Conflict Minerals Reporting Template* (available at **http://www.conflictfreesourcing.org/conflict-minerals-reporting-template/**).

[11] U.S. Gov't Accountability Office, *Conflict Minerals: Stakeholder Options for Responsible Sourcing Are Expanding, but More Information on Smelters Is Needed*, GAO-14-575 (Jun. 26, 2014) at p. 16 ("According to SEC officials, based on preliminary feedback they received, they anticipated that most SEC-reporting companies subject to the [conflict minerals rule] would be unable (*cont.*)

companies were not able to drill down to the countries of origin of their necessary conflict minerals, the mines from which the minerals were extracted, or, further, to the facilities in which such minerals were processed. But some companies were also incentivized not to label their products "DRC conflict free," since doing so would have triggered the independent audit requirement.

The SEC guidance following the D.C. Circuit Court's ruling makes clear that, even though companies are not required to use the specific labeling terminology contemplated in Form SD, an independent audit is nevertheless required where a company states that its products are "DRC conflict free." Unsurprisingly, then, only one company surveyed declared its supply chain to be completely "DRC conflict free." One company indicated that certain of its products were "DRC conflict free" but that others were "DRC conflict undeterminable," while another company indicated that one line of its products was "DRC conflict free" for tantalum specifically. Of the three companies that explicitly stated that some or all of their products were "DRC conflict free," two included the required independent audit report.

Many companies declined to explicitly describe the results of their diligence, an avenue left open to them after the court decision and SEC reaction. Only 21% of S&P 500 filers and 25% of S&P 400 filers surveyed explicitly used the phrase "DRC conflict undeterminable" to label their products in their Conflict Mineral Reports, though an additional 58% of S&P 500 filers and 61% of S&P 400 filers surveyed included statements to substantially the same effect in their reports. While most companies that included a Conflict Minerals Report expressed uncertainty as to the origin or conflict status of their conflict minerals, 23% of S&P 500 and 12% of S&P 400 companies that expressed uncertainty without explicitly stating that their products are "DRC conflict undeterminable" also included statements indicating that they had no reason to believe that their necessary conflict minerals financed armed conflict or that they came from the covered countries. In many cases, these statements were alongside explicit admissions of incomplete information. These companies, none of which provided an independent audit, appear to have interpreted the SEC guidance not to apply to "negative assurances" about conflict-free status.

Other companies provided the results of their supplier outreach, often in great detail, without any concluding statement or explicit acknowledgment of their conflict minerals determination. As a result of the ambiguities discussed above and the range of information presented, categorizing a company's diligence results was an inherently subjective exercise.

Even though the SEC excused companies from explicitly labeling products as "DRC conflict undeterminable" or "not found to be DRC conflict free," the SEC advised that, for products that fell into these buckets, companies should nevertheless disclose the facilities used to produce the conflict minerals, the country of origin of the conflict minerals and the efforts to determine the mine or location of origin of the conflict minerals. We saw companies attempt to address these requirements with varying degrees of clarity. Some companies included clear headings that corresponded to these data points, under which companies provided detailed information including thorough walk-throughs of their efforts. However, many companies included only vague references or high-level summaries of their efforts without any specifics. Roughly one third of companies surveyed included some information about the smelters or refiners that provided their necessary conflict minerals. In some cases, this information took the form of extensive lists of the identified smelters or refiners with country of origin and conflict-free status indicated, while in other cases this information was simply a statement indicating the number of smelters or refiners that were identified as a result of the company's RCOI or diligence efforts, both with and without details regarding conflict-free status.

Although Form SD requires only a company labeling its products "DRC conflict undeterminable" to disclose the steps taken or planned to mitigate the risk that its necessary conflict minerals benefit armed

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(*cont.*)

to determine whether or not their products qualified as "DRC conflict-free.") (available at **http://www.gao.gov/products/GAO-14-575**).

conflict, we found that many companies, including those that did not use the "undeterminable" label, addressed this point.

Disclaimers and Boilerplate

A handful of companies included disclaimers about their data gathering efforts in both RCOI and due diligence discussions. Most often this language related to the accuracy or completeness of information received from suppliers or other external parties in the supply chain.[12] More frequently, we found that companies explicitly mentioned that they were downstream users of conflict minerals, and as a result were relying upon information provided by third parties in the supply chain.

A significant number of filers included boilerplate language in some form in their conflict mineral filings. Around a quarter of companies included a legal disclaimer, most often regarding forward-looking statements. Around a third included a disclaimer against incorporation by reference when including a link to the company website.

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Human rights advocates were quick to slam the initial conflict mineral filings as inadequate, but the SEC—or perhaps Congress—will have the final word.[13] The rule remains in litigation and the timing and nature of a resolution are uncertain. As of this writing, control of the U.S. Senate is expected to be in play in the 2014 midterm elections. Given the antipathy for the rule demonstrated by the U.S. Chamber of Commerce and other lobbying groups, it seems possible that if control of both houses of Congress rests in Republican hands after the midterm elections, a bill to repeal Section 1502 of the Dodd-Frank Act—along with the SEC's obligation to promulgate the conflict minerals rule—could be on the agenda. While repeal of Section 1502 would be strongly resisted by human rights groups and some members of Congress, it would perhaps enable the SEC to redirect scarce resources to its core corporate disclosure, market regulation and enforcement roles and away from ever-proliferating "specialized disclosure" mandates.[14]

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[12] Examples of these disclaimers include: "Such sources of information may yield inaccurate or incomplete information and may be subject to fraud" and "There are factors that could affect the accuracy of these statements. These factors include, but are not limited to, incomplete supplier data or available smelter data, errors or omissions by suppliers or smelters, evolving definition and confirmation of smelters, incomplete information from industry or other third-party sources, continuing guidance regarding the . . . final rule, and other issues."

[13] E.g., "The first set of company reports submitted under a landmark U.S. law that aims to stop the minerals trade fuelling violence in eastern Democratic Republic of Congo (DRC) fall short of the mark, warns Global Witness." Global Witness (Jun. 2, 2014) (available at **http://www.globalwitness.org/library/global-witness-warns-majority-inaugural-conflict-mineral-reports-are-inadequate**).

[14] For example, the Iran Threat Reduction and Syria Human Rights Act of 2012 requires each SEC-reporting issuer to disclose information regarding certain activities relating to Iran, particularly new investments or new transactions relating to the Iranian petroleum, petrochemical or marine transport sectors. See Davis Polk Client Memorandum, *New Law Requires Issuers to Disclose Certain Iran-Related Transactions* (Sept. 5, 2012) (available at **http://www.davispolk.com/download.php?file=sites/default/files/files/Publication/5582a18f-bbb4-4a9d-8460-081d04b67cc5/Preview/PublicationAttachment/0bfb3e4b-6b59-42f5-86ad-10493c25f561/090512_Iran_Related.pdf**). In addition, Section 1504 of the Dodd-Frank Act requires disclosures by resource extraction issuers about certain payments to governments. See Davis Polk Client Newsflash, *SEC Adopts Final Rules Implementing Dodd-Frank Disclosure Requirements for Resource Extraction Issuers* (Aug. 22, 2012) (available at **http://www.davispolk.com/download.php?file=sites/default/files/files/Publication/fa61c3e4-427f-4ca8-89a4-14194d722b7a/Preview/PublicationAttachment/12f4f5bf-096b-4413-b738-1ea3fe20d068/082212_Resource_Extraction.pdf**).

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