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SEC Disclosure and Corporate Governance

Congressional Use of the Federal Securities Laws To Achieve Social and/or Foreign Policy Goals: Trend or Aberration?

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This article has been revised to reflect recent developments.

Introduction and Summary

Many domestic and foreign companies that file periodic reports with the US Securities and Exchange Commission ("SEC" or "Commission") are now coming to grips with three novel and highly prescriptive disclosure requirements dictated by Congress. What distinguishes these new requirements from most, if not all, existing securities disclosure standards is their unique focus on achieving humanitarian and/or foreign policy objectives that are largely unrelated to the central purposes of the federal securities laws – the protection of investors and the facilitation of efficient capital formation and secondary market trading through full and fair disclosure. Two "miscellaneous" provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") instruct the SEC to adopt rules: (1) under Section 1502, to require public companies to disclose the use in their products of specified "conflict minerals," as a means of "further[ing] the humanitarian goal of ending the extremely violent conflict in the DRC [Democratic Republic of the Congo], which has been partially financed by the exploitation and trade of conflict minerals originating in the DRC;"[1] and (2) under Section 1504, to "increase the transparency of payments made by oil, natural gas and mining companies to governments for the purpose of the commercial development" of these natural resources, thereby "help[ing] to empower citizens of these resource-rich countries to hold their governments accountable for the wealth generated by those resources."[2]

Although they became effective on November 13, 2012, the SEC's final rules implementing Sections 1502 and 1504 of the Dodd-Frank Act do not compel the filing of a disclosure document with the SEC until the first half of 2014, pursuant to a new Form SD (for "Specialized Disclosure"). In the meantime, some business organizations have brought suit to challenge the validity of both the conflict minerals and resource extraction payment rules adopted by the SEC.[3] At this point, it is difficult to predict whether either or both sets of rules will be invalidated upon judicial review.[4] Accordingly, companies potentially affected should proceed with efforts to determine whether they are covered by either of the new rules and, if so, what investments will need to be made, and resources deployed, to ensure timely compliance.

Another federal statute, the Iran Threat Reduction and Syria Human Rights Act of 2012 ("Iran Threat Reduction Act"), mandates (among numerous other items) disclosure, in periodic reports "required" to be filed after February 6, 2013, of whether the registrant or any of its affiliates "knowingly" engaged in certain enumerated activities involving Iran wthat could expose the registrant to the imposition of sanctions by the US government. If a registrant determines that it, or any of its affiliates, has engaged in such activities, the registrant must provide specified information both in the relevant periodic report, and in a separate notice that must be filed concurrently with the SEC. Although no SEC rulemaking is necessary to implement this provision, the statutory language does not foreclose the possibility of SEC or Staff interpretive guidance. In fact, the SEC's Division of Corporation Finance recently answered several important interpretive questions raised by Section 219, as discussed below. Perhaps most important among them are two Staff interpretations indicating that: (1) companies whose next annual (or quarterly) report is due after February 6, 2013 (meaning that the filing deadline falls after the statutory effective date), may not avoid compliance with Section 219 simply by filing their reports in advance of the February 6 effective date;[5] and (2) the statute, which became law in August 2012, has a retroactive effect; as a result, calendar-year registrants will have to review their own activities, as well as those of US and non-US affiliates, beginning January 1, 2012.

All three statutes addressed in this article amend Section 13 of the Securities Exchange Act of 1934, as amended ("Exchange Act"), which means that violation of any of this triad of new disclosure requirements potentially could result in SEC enforcement action. And all three will compel domestic and foreign registrants to make difficult judgments as to whether they are covered and, if so, how best to design and implement disclosure controls and procedures necessary to ensure that the required information is collected, analyzed, and reported within the specified time periods. Of the three, the conflict minerals provisions implemented by SEC rulemaking may affect the most issuers – approximately 6,000, according to an SEC estimate.[6]

This article analyzes each of the three new "specialized" reporting obligations, and offers some practical suggestions on what to do now and where to look for additional guidance. Companies should recognize that there is no realistic way to truncate the highly fact-specific and individualized analysis demanded by these novel disclosure requirements. On the other hand, a company that takes the time and trouble to engage in this analysis may find, for example, that the availability of generous "grandfather" provisions under the conflict minerals rule, or the application of the *de minimis* threshold for disclosure of governmental resource extraction payments, may lead to reduced costs and other burdens.

It remains to be seen whether these unprecedented amendments to the federal securities laws represent aberrations or, instead, signal the emergence of a trend. Because legislatures and/or regulators in other countries are considering similar requirements, however, compliance with disclosure rules designed to achieve social and/or foreign policy goals without regard to the possible impact on companies or their investors eventually may become an unavoidable cost of doing business on a global scale.

Conflict Minerals

Section 1502(b) of the Dodd-Frank Act added a new Section 13(p) to the Exchange Act, directing the SEC to adopt rules imposing new annual disclosure and reporting obligations on reporting companies that use specified "conflict minerals" originating in the DRC or an "adjoining" country (together, "Covered Countries")[7] and are deemed "necessary to the functionality or production of a product" that is either manufactured by such a company, or by a third party with which the company contracts for such manufacture. After a lengthy comment period – the proposing release was issued for public comment in December 2010,[8] followed by a public roundtable in October 2011 – a divided SEC voted to adopt new Rule 13p-1 and Form SD in late August 2012.[9] From an issuer's perspective, the delay may have been worthwhile; the SEC's final rules, while still somewhat complex given the highly prescriptive language of Section 13(p), reflect some practical accommodations responsive to public comment and are easier to understand and apply than the version originally proposed.

Despite their seeming complexity, the requirements of new Rule 13p-1 and Part 1 of Form SD (applicable to conflict minerals) boil down to three basic analytical steps. **Step One** requires any company that files periodic reports with the SEC (a "registrant"),[10] regardless of its size or country of origin, to determine whether "it … [has] conflict minerals that are necessary to the functionality or production of a product manufactured or contracted by that registrant to be manufactured…."[11] **Step Two** comes into play only if the answer to the question posed in **Step One** is "yes," and requires the registrant to conduct a good-faith, "reasonable country of origin inquiry" that has been "reasonably designed" to determine whether any of its conflict minerals either originated in a Covered Country (again, the DRC or an adjoining country), or was derived from recycled or scrap materials. Regardless of the outcome of this inquiry, the registrant will have to file – and post on its website – a Form SD that discloses certain information about its inquiry in accordance with line-items set forth in Section 1 of the Form.[12]

If the registrant must proceed to **Step Three** – which will happen when the registrant knows or has reason to believe that its necessary conflict minerals may have originated in the Covered Countries, and may not have come from recycled or scrap sources – the registrant will have to exercise "due diligence" on the source and chain of custody of those minerals using the only nationally or internationally recognized due diligence framework now in existence – the guidance approved by the Organisation for Economic Co-operation and Development, or OECD. Depending on the outcome of the diligence process, moreover, the registrant may be required to file an audited Conflict Minerals Report as an exhibit to its Form SD, and post this information on its website.

The following explanation of the Commission's three-step regulatory analysis is drawn from the language of Rule 13p-1 and Part 1 of Form SD (pertaining to conflict minerals disclosure), as well as the Conflict Minerals Adopting Release. The SEC's flowchart, which appears on page 33 of the Release, is particularly helpful to companies applying the rules' tripartite analysis.

Step One – Issuers Covered by the Final Rules

Assuming a company is a "registrant" – either because it is a domestic company filing Form 10-K's and 10-Q's, a foreign private issuer filing annual reports on Form 20-F, a "smaller reporting company"[13] or a reporting "Emerging Growth Company" as defined under the JOBS Act of 2012[14] – the registrant first must determine whether any "conflict minerals" actually contained in any of its products are "necessary to the functionality or production" of a product, regardless of whether the registrant has manufactured that product itself or contracted with a third party for such manufacture. If the answer to this threshold inquiry is negative, "the issuer is not required to take any action, make any disclosures, or submit any reports …."[15]

An understanding of certain defined terms and concepts is critical to the appropriate application of this first step. These terms and concepts are described and discussed below.

"Conflict Minerals" Definition

Consistent with Section 13(p), the final rules define the term "conflict mineral" broadly to mean gold, columbite-tantalite (also known as coltan), cassiterite, and wolframite, along with their derivatives, which the SEC has indicated are limited (for now) to tantalum, tin, and tungsten (known as the "3Ts" and, with gold, the "3Ts & G"). The US Secretary of State has the power to determine that additional derivatives are financing conflict in the Covered Countries.[16] For purposes of this definition, the country of origin of any of the enumerated minerals is irrelevant.

One or more of the 3Ts & G may appear in a wide variety of products manufactured in multiple industrial sectors, such as jewelry, electrical lighting, jet engines, dental and medical devices, cell phones, computers and other consumer electronics products, semiconductors, industrial machinery, automobiles, and even preservative packaging for certain food and pharmaceutical products. Because there is no *de minimis* threshold in either the statute or the implementing rules, even a trace amount of one of these minerals in the final product may trigger a reporting obligation (if intentionally added, as explained below).

Exclusion of Conflict Minerals Outside the Supply Chain Before January 31, 2013

A limited "grandfather" provision for existing mineral stock, together with the extended phase-in period for "undeterminable conflict minerals" discussed below, will facilitate compliance by affected companies in 2013. Conflict minerals that are "outside the supply chain" prior to January 31, 2013 – meaning that they were fully smelted (in the case of the 3Ts) or refined (gold), or, if not fully smelted or refined, are located outside of any of the Covered Countries – are not subject to the new rules.[17] While recognizing that stockpiled conflict minerals may have financed armed conflict at some point in the past, the SEC observed that "it appears unlikely that they could further finance or benefit armed groups" once smelted, refined or moved outside of the Covered Countries.[18]

"Manufacture" and "Contract to Manufacture"

Although the SEC has chosen not to define the terms "manufacture" or "contract to manufacture" in the new rules, the Conflict Minerals Adopting Release offers some useful interpretative guidance. Some companies that extract, or otherwise work with products containing, conflict minerals are excluded entirely from coverage. Among those companies thus excluded are mining companies that otherwise do not refine, smelt or engage in manufacturing involving any of the minerals they extract, and companies that merely service, maintain or repair a product.[19] On the other hand, companies that buy components made by third parties to create their own products – obvious examples are automobile and jet manufacturers that purchase components containing any of the 3Ts & G – *will* be covered.

The determination of whether a registrant "contracts [with a third party] to manufacture" a product (including a component)[20] will depend on the level of influence exercised by the registrant over the third party's manufacturing processes. As the SEC points out, "[t]he degree of influence necessary for an issuer to be considered to be contracting to manufacture a product is based on each issuer's individual facts and circumstances."[21] According to the SEC, a registrant would not be deemed to have influence over manufacturing by a third party, within the meaning of the new rules, if its actions involve no more than:

- specifying or negotiating contractual terms with a manufacturer that do not directly relate to the manufacturing of the product, such as training or technical support, price, insurance, indemnity, intellectual property rights, dispute resolution, or other like terms or conditions concerning the product, unless the registrant specifies or negotiates taking these actions so as to exercise a degree of influence over the manufacturing of the product that is practically equivalent to contracting on terms that directly relate to the manufacturing of the product.
  - The example given by the SEC is a "service provider" that, in purchasing cell phones for retail sale, specifies to the manufacturer of these phones that they must be able to function on a certain network. This activity alone would not give rise to the requisite degree of influence.
  - Conversely, a registrant that, in contracting with a manufacturer, specifies that a particular conflict mineral must be included in a particular product would be covered by the new rules;
- affixing the registrant's brand, marks, logo, or label to a generic product manufactured by a third party; or
- servicing, maintaining, or repairing a product manufactured by a third party.

When Conflict Minerals Are "Necessary to the Functionality or Production" of a Product

Like the proposed rules, the final rules do not define when a conflict mineral will be deemed "necessary" either to the "functionality" or the "production" of a product. Once again, however, the Adopting Release provides some constructive interpretative guidance.

Perhaps most importantly, the SEC concluded that only a conflict mineral that is actually contained in a given product will qualify as "necessary to the functionality or production" of that product within the meaning of the final rules.[23] Moreover, such conflict mineral must have been intentionally added to the product or the production process.[24] Keep in mind the need in this context to analyze both the product as a whole, as well as each component (regardless of whether the issuer itself manufactured that component), and to remember that even "minute" amounts of a conflict mineral may be "necessary" to a product's functionality or manufacture.[25]

An issuer evaluating whether its conflict minerals are "necessary to the functionality" of a product should consider:

- whether a conflict mineral is contained in and intentionally added to the product or any component of the product, and is not a naturally-occurring by-product;
- whether a conflict mineral is necessary to the product's generally expected function, use, or purpose, focusing on each; e.g., a smart phone has multiple expected uses, such as accessing the Internet, making or receiving phone calls, and listening to stored music – if a conflict mineral is necessary to the function, use or purpose of any of these applications,

the SEC considers it necessary to the functionality of the phone; or

- if a conflict mineral is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration – the example cited here is the gold included in a pendant attached to a necklace worn primarily for ornamentation or decoration.[26]

Depending on the relevant facts and circumstances, application of any of these factors may be dispositive – either individually or in the aggregate.

In determining whether its conflict minerals are "necessary to the production" of a product, a registrant should consider whether a conflict mineral is contained in the final product and intentionally added during the product's production process, including the production process of any component of the product. Use of a conflict mineral as an essential catalyst in the manufacturing process alone will not suffice; rather, that conflict mineral also must be present in the final product. Nor will the presence of a conflict mineral in manufacturing tools or machinery be enough to trigger the final rules, even if the particular tool or machine is needed to make the product (or component).[27]

Step Two – Determining Whether Conflict Minerals Originated in the Covered Countries, or Came from Recycled or Scrap Materials: The "Reasonable Country of Origin Inquiry" and New Form SD

Once a registrant concludes that conflict minerals are necessary to the functionality or production of a product that it manufactured or contracted to be manufactured, the final rules require the registrant to conduct a "reasonable country of origin inquiry" aimed at discovering whether its conflict minerals either originated in the Covered Countries, or came from recycled or scrap materials. A registrant may stop at Step Two if, after conducting the reasonable country of origin inquiry, its conflict minerals *either*: (1) *did not originate* in the Covered Countries, or *did come* from recycled or scrap sources; *or* (2) the registrant has *no reason to believe* that its conflict minerals *may have originated* in the Covered Countries, or the registrant *reasonably believes* that its conflict minerals come from recycled or scrap sources.[28] Otherwise, the registrant must proceed to Step Three and perform the prescribed due diligence as discussed further below. Even if a registrant decides that it may stop at Step Two, however, it still must file a Form SD with the Commission disclosing this determination, briefly describing the reasonable country of origin inquiry undertaken, and detailing the inquiry's results, and post this information on the registrant's website. (More on Form SD below).

Reasonable Country of Origin Inquiry

The new rules do not specify what factors must be present to demonstrate the requisite "reasonableness" of a registrant's inquiry, in light of the Commission's judgment that this determination necessarily must depend on each issuer's particular facts and circumstances. Such flexibility is essential, in the Commission's view, because "a reasonable country of origin inquiry can differ among issuers based on the issuer's size, relationships with suppliers, or other factors …. [such as] the available infrastructure at a given time." That said, the Conflict Minerals Adopting Release and final rules outline the following general standards governing the inquiry, along with the steps that must be taken as a result of this inquiry:

- First and foremost, to satisfy the reasonable country of origin requirement, a registrant's inquiry must be BOTH (a) reasonably designed to determine whether the issuer's conflict minerals originated in the Covered

Countries, or came from recycled or scrap sources, AND (b) performed in good faith;

- This two-pronged standard does not demand absolute certainty with regard to a conflict mineral's origins. To illustrate this point, the Commission stated its belief that the reasonable country of origin standard will be met if the registrant "seeks and obtains reasonably reliable representations indicating the facility at which its conflict minerals were processed and demonstrating that those conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources."[29] These representations can come directly from the facility at which the registrant's conflict minerals were processed, or indirectly through its immediate suppliers.
  - There is a catch – "the issuer must have a reason to believe that these representations are true given the facts and circumstances surrounding those representations," and take into account "any applicable warning signs or other circumstances indicating that its conflict minerals may have originated in the Covered Countries or did not come from recycled or scrap sources." Two potential "red flags" are identified in the Conflict Minerals Adopting Release: (a) the conflict minerals are claimed to have originated in a country with limited known reserves of such minerals;[30] and (b) the registrant becomes aware that some of its conflict minerals were processed by a so-called "mixed smelter," or a smelter known to source from many countries, including the Covered Countries, but is unable to determine whether such minerals originated in the Covered Countries.[31]
- A registrant would have a reason to believe a processing facility's representations were true if such facility (a) received a "conflict-free" designation by a recognized industry group that requires an independent private-sector audit of the smelter (or refinery in the case of gold), or (b) is not part of an industry group's "conflict-free" designation process, but obtained its own independent private-sector audit that is made publicly available. The Commission observed in the context of this discussion (at page 149 of the Conflict Minerals Adopting Release) that a registrant's "policies with respect to the sourcing of conflict minerals will generally form a part of the issuer's reasonable country of origin inquiry, and therefore would generally be required to be disclosed in the issuer's Form SD;" and
- Finally, a registrant is not required to obtain representations from all of its suppliers in order to demonstrate the necessary "reasonableness" of its inquiry. In the SEC's view, a registrant that does not hear from all of its suppliers nevertheless may conclude that its conflict minerals did not originate in the Covered Countries, so long as its country of origin inquiry is reasonably designed and performed in good faith, and the registrant does not ignore warning signs or other circumstances indicating that any of the conflict minerals for which it did not receive a representation originated in the Covered Countries.[32]

New Form SD – Location, Timing, "Filed" Status, and Content if Filed at Step Two

The final rules reflect several welcome changes from the proposed rules. To avoid adding more burdens to the annual financial reporting process, the Commission shifted the new conflict minerals disclosures out of the annual report on Form 10-K, 20-F, or 40-F, and into a new Exchange Act form, Form SD, that need not be filed until May 31 of each calendar year.

Accordingly, the Sarbanes-Oxley-prescribed CEO and CFO certifications accompanying periodic reports filed under the Exchange Act will not cover the information disclosed in a Form SD (absent affirmative incorporation by reference of Form SD into such reports). Nor will Form SD be subject to automatic incorporation by reference into any registration statement filed under the Securities Act of 1933, as amended (Securities Act)– here again, a registrant must make an affirmative choice to incorporate by reference.

The annual reporting cycle for Form SD is tied to the calendar year, rather than to a particular registrant's fiscal year (as had been proposed), which the Commission concluded would be less burdensome for both issuers and suppliers.[33] Within a given calendar year, a potential disclosure obligation now will be triggered by the *completion* of any product containing a conflict mineral – whether that product is manufactured by the registrant itself, or by a third party pursuant to contract.[34] By contrast, the proposed rules would have linked the disclosure trigger to the date on which the registrant took possession of a particular conflict mineral. In explaining this modification, the Commission observed that "it should be relatively easy for an issuer to identify when the manufacture of a product is completed, as the issuer has a certain amount of control over this decision."[35]

Companies previously outside the scope of the new rules that acquire or otherwise obtain control of another company whose conflict minerals activities would cause the acquiring company to incur a Form SD reporting obligation, will have a grace period of up to eight months after the effective date of the acquisition in which to come into compliance. In other words, the acquiror's conflict minerals disclosure obligation stemming from an acquisition can be delayed until the end of the first calendar year that begins no sooner than eight months after the acquisition's effective date.[36]

Unfortunately, the final rules also mandate that the new Form SD (and accompanying Conflict Minerals Report, discussed below under Step Three) must be "filed," rather than "furnished," as originally proposed – which means that the new disclosures will be subject to private litigation under Section 18 of the Exchange Act. Section 18 creates a private remedy that requires a plaintiff to plead and prove a materially false or misleading statement, fraudulent intent, reliance, and loss/damages. As a mitigating factor, the Commission noted that a company has the ability to avoid liability by establishing that it acted in good faith and had no knowledge that any statement was false or misleading.[37] At the same time, the Commission made clear that failure to comply with the new rules could lead to a Commission enforcement action under Exchange Act Sections 13(a) and (p) and 15(d), as applicable, as well as Exchange Act Section 10(b) and Rule 10b-5 thereunder.[38]

As previously discussed, the content of a Form SD filed at Step Two is relatively simple and straightforward. To summarize, a registrant that concludes, based on its reasonable country of origin inquiry, that: (1) its necessary conflict minerals did not originate in the Covered Countries or came from recycled/scrap sources; or (2) the registrant has no reason to believe that its necessary conflict minerals may have originated in a Covered Country, or reasonably believes that these minerals came from recycled/scrap sources, is not required to provide the detailed information called for in a Conflict Minerals Report. Instead, a registrant permitted to stop at Step Two must file a Form SD disclosing, under a separate heading entitled "Conflict Minerals Disclosure," the registrant's determination based on its reasonable country of origin inquiry (either (1) or (2), above), a brief description of that inquiry and the results thereof, and a link to the registrant's website where the information disclosed in the Form SD can be found.[39]

Step Three – Due Diligence and the Conflict Minerals Report

A registrant must go on to exercise due diligence, in the wake of its reasonable country of origin inquiry, if it *knows* that its necessary conflict minerals originated in the Covered Countries and *did not derive* from recycled/scrap sources, *or has reason to believe* that these minerals may have originated in the Covered Countries *and may not have derived* from recycled/scrap sources.[40] Rather than try to define what constitutes adequate "due diligence," an inherently fact-based determination, the final rules require simply that a "registrant's due diligence must conform to a nationally or internationally recognized due diligence framework, if such a framework is available for the conflict mineral," and must "include but not be limited to an independent private-sector audit of the Conflict Minerals Report that is conducted in accordance with standards established by the Comptroller General of the United States and certified " by the registrant.[41] As indicated above, the single such framework known to exist at this time is the OECD's due diligence guidance.

The final rules allow for the possibility that performance of the mandated due diligence might reveal that conflict minerals the registrant originally believed may have originated in the Covered Countries and not from recycled/scrap materials, in fact did not originate from the Covered Countries, or did come from recycled/scrap sources. Should that occur, the registrant is not required to file a Conflict Minerals Report as an exhibit to its Form SD, but still must disclose in the body of the Form its determination regarding the conflict minerals' origin, and briefly describe both the reasonable country of origin inquiry and the due diligence measures it undertook in making this determination, together with the results "of the inquiry and due diligence efforts it performed."[42] Otherwise, the registrant must file a Conflict Minerals Report as an exhibit to its Form SD, stating in the body of the Form that the Report is attached as an exhibit and is publicly available on the registrant's Internet website (including in the Form the link to the posted Report).[43]

It is also possible that, despite its best efforts to exercise due diligence, a registrant ultimately will be unable to determine the source of its conflict minerals. For a limited transition period, the length of which varies with the size of the registrant – four years for "smaller reporting issuers" and two years for all other affected issuers -- the registrant will be permitted to forego the independent audit and refer to its products in a Conflict Minerals Report as "DRC conflict undeterminable." The benefits of this temporary designation are discussed further in the next section.

Content of the Conflict Minerals Report

The Conflict Minerals Report (Item 1.02 of Form SD, Exhibit) must contain a description of the company's due diligence processes, a copy of an independent third-party audit report and certification that this audit has been obtained, naming the auditor and, for each product that has *not* been found to be "DRC conflict-free," a description of the product, along with certain additional information. A product that is "DRC conflict-free" by definition does not contain any "necessary" conflict minerals "that directly or indirectly finance armed groups," or groups that are identified in the US State Department's annual Country Reports on Human Rights Practices as perpetrators of serious human rights abuses in the Covered Countries.[44] Conflict minerals that a company "obtains from recycled or scrap sources … are considered DRC conflict free."[45]

A more detailed discussion of these basic elements of the Conflict Mineral Report is presented below. As you review these elements, keep in mind that the Conflict Minerals Report, like the Form SD to which this Report must be attached as an exhibit and filed with the SEC, must provide information only for those products containing "necessary" conflict minerals whose manufacture (whether by the company, or by a third party pursuant to a "contract to manufacture," as explained above) was completed during the reporting cycle – the preceding calendar year.[46]

Description of Company's Due Diligence Measures, Including but not Limited to Independent Private-Sector Audit

A Conflict Minerals Report must include a description of the measures taken by the company to exercise due diligence in determining the source and chain of custody of its "necessary" conflict minerals. Section 13(p) itself is not specific regarding the particular due diligence steps that must be taken, with one exception – the statute makes clear (in Sections 13(p)(1)(A)(i) and 13(p)(1)(B)) that a "critical component" of such diligence is an independent private-sector audit that is conducted in accordance with generally accepted governmental auditing standards ("GAGAS") as established by the Comptroller General of the United States and the Government Accountability Office ("GAO"). Section 13(p)(1)(C) gives the SEC the power to determine that a company's independent private-sector audit, or any other diligence process for that matter, is "unreliable."[47] There is no indication in the Conflict Minerals Adopting Release as to how the SEC might wield this power, beyond the assurance therein that proper adherence to the OECD's "Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas" ("OECD Due Diligence Guidance")[48] will afford companies "a degree of certainty and … 'ameliorate the risk that a due diligence process will later be judged to be unreliable.'"[49] An SEC finding that an audit (or any other diligence measure) is "unreliable" would mean that the Conflict Minerals Report to which the defective audit relates would be deemed to violate Section 13(p)'s reporting requirement.

To provide a framework for the independent private-sector auditor's assessment of audit objectives that is consistent with GAGAS (also known as the "Yellow Book"), the final rules require that a company obligated to proceed to Step Three must follow a nationally or internationally recognized due diligence framework. At this time, as noted, the only such framework expressly recognized by the SEC as sufficient for this purpose is the OECD's Due Diligence Guidance. The independent auditor's report, which must be filed as part of the Conflict Minerals Report, must state an opinion or conclusion on whether: (1) the design of the company's due diligence measures, as set forth in, and with respect to the period covered by, the company's Conflict Minerals Report, is in conformity, in all material respects, with the criteria outlined in the OECD's Due Diligence Guidance; and (2) the company's description of the due diligence measures it performed, as set forth in, and with respect to the period covered by, the Conflict Minerals Report, is consistent with the due diligence process that the company actually undertook.[50] Although the company's PCAOB-registered public accounting firm need not be retained to perform the GAGAS audit,[51] the SEC indicated that a company choosing to engage its independent registered public accounting firm to conduct a conflict minerals audit may do so without necessarily impairing that firm's SEC-prescribed independence for purposes of the company's financial statement audit.[52]

For its part, the company must certify that it obtained the requisite independent third-party audit, include this certification in the Conflict Minerals Report, and disclose the identity of the auditor.[53] In response to commentators' concerns, the final rules clarify that the company's audit certification need not be signed by an individual officer; instead, this certification will take the form of a statement by the company in its Conflict Minerals Report that it has obtained an independent private-sector audit.[54]

Additional guidance in the Conflict Minerals Adopting Release (at pages 207-208) urges each affected company to base its due diligence description on the company's own individual facts and circumstances. If the company's diligence processes are relatively consistent throughout the supply chain, a general description of this process may be appropriate. However, if the company uses different due diligence processes for different aspects of its supply chain (for example, for different conflict minerals or products), the company should describe how these processes differ. With respect to whether a company may rely on "reasonable representations from suppliers and/or smelters [or refineries, in the case of gold] in satisfying its due diligence requirement," the SEC stated simply that the answer is dependent on the OECD Due Diligence Guidance.[55]

Special Considerations Raised by Due Diligence on Conflict Minerals from Recycled or Scrap Sources, and Related Disclosure

As previously discussed, a company that has reason to believe, after conducting a reasonable country of origin inquiry (Step Two), that its "necessary" conflict minerals *may not* have come from recycled or scrap sources must engage in the due diligence required by Step Three. Unless this diligence reveals that the particular conflict minerals in fact originated from recycled or scrap sources, the company must file a Conflict Minerals Report as part of its Form SD – even if the company ultimately is unable to determine one way or the other that these minerals came from recycled or scrap sources.[56]

That brings us to the question of whether there is a special OECD due diligence framework that will enable a company to discern whether its conflict minerals came from recycled/scrap sources. For now, the only "nationally or internationally recognized due diligence framework" available for conflict minerals derived from recycled/scrap sources is limited to the OECD's Gold Supplement.[57] Until such a framework is developed for the other designated minerals,[58] companies therefore must decide for themselves how to conduct the necessary diligence for any of the "3Ts," and disclose the diligence measures they employed.

Other Disclosures Required in the Conflict Minerals Report

The final rule further requires that the Conflict Minerals Report include, for each product containing any "necessary" conflict mineral that is not "DRC conflict free," a description of each such product, the smelter or refinery used to process the conflict mineral, the country of origin of such mineral, and the efforts to determine the mine or location of origin with the greatest possible specificity.

With respect to conflict minerals that a company can confirm, after performing the requisite due diligence, came from recycled or scrap sources, the final rules treat these minerals as "DRC conflict free" (as explained above at note 45 and accompanying text). As a result, that company is not obligated to disclose the processing facilities, country of origin, and/or efforts to determine the mine or location of origin of these minerals. By the same token, as explained above, the company still must disclose the due diligence measures taken in the Conflict Minerals Report.

During a temporary "grace period" that varies in length with the size of the company – four years for smaller reporting issuers, and two years for other registrants[59] – a company that is unable to determine that its conflict minerals did not originate in the Covered Countries, did not directly or indirectly benefit armed groups, or came from recycled or scrap sources, will be permitted to describe products containing those conflict minerals as "DRC conflict undeterminable." The term "'DRC conflict undeterminable' means, with respect to any product manufactured or contracted to be manufactured by a registrant, that the registrant is unable to determine, after exercising due diligence [on the source and chain of custody of its "necessary" conflict minerals] as required by paragraph (c)(1) of … [Item 1.01 of Form SD], whether or not such product qualifies as DRC conflict free."[60]

One of the most important benefits of using the "DRC conflict undeterminable" classification is that no audit report need be obtained with respect to conflict minerals in an eligible product. However, a company whose products are eligible for such favorable treatment still must disclose the following in its Conflict Minerals Report:

- a description of its due diligence measures (minus the audit);
- the steps it has taken or will take, if any, since the end of the period covered in its most recent prior Conflict Minerals Report to mitigate the risk that its necessary conflict minerals will benefit armed groups, including any steps to improve its due diligence;
- the country of origin of the conflict minerals, if known;
- the facilities used to process (i.e. smelt or refine) the conflict minerals, if known; and
- the efforts to determine the mine or location of origin with the greatest possible specificity, if applicable.[61]

Once the transition period ends, companies that reach Step Three must describe their products either as "DRC conflict free," or as having "not been found to be 'DRC conflict free.'" Regardless of which category applies, the mandatory audit must be performed as an essential element of due diligence. Companies are free to add explanatory disclosure if they are concerned that investors might not understand the significance of the term "not been found to be 'DRC conflict free.'" For example, a company could explain the regulatory definition of "DRC conflict free" when describing products that have not been found to be "DRC conflict free," or otherwise address its particular situation.[62]

What Should Affected Companies Consider Doing Now?

Companies should not defer consideration of the potential applicability of the new conflict minerals rules and, if necessary, the development of appropriate compliance policies and procedures, in the hope that these rules will be stricken in a litigation context. Even if the new rules ultimately were to be invalidated by the courts, the emergence of initiatives focusing on trade in conflict minerals, at the state level and abroad,[63] and the extensive investment in compliance measures already made by various companies in the electronics and jewelry sectors (among others), suggest that competitive considerations alone, coupled with the heightened expectations of customers and other stakeholders (including certain activist investors), would prompt many global companies voluntarily to follow the OECD Due Diligence Guidance and provide related disclosure.

With these factors in mind, and depending on their industry and the complexity of their supply chains, public companies may wish to consider taking the following steps:

- Identify any products the company manufactures, or contracts with a third party to manufacture, that might contain conflict minerals – essentially, the 3Ts and gold. This assessment must include product components that may be manufactured by other companies.
- On a product-by-product basis, analyze whether one or more conflict minerals is "necessary to the functionality or production" of each product, including components. If a product or component is manufactured by a third party, consider the SEC guidance on "contract to manufacture" (discussed above).
- Find out what your peers and other affected companies and/or industry groups are doing to design and implement Section 13(p) compliance controls and procedures; some of them may be participating in pilot supply-chain tracking programs or other initiatives sponsored by the OECD,[64] the US State Department[65] and various private-sector organizations. Notable examples include: (1) the EICC-GeSI Work Group, which is running a pilot Conflict-Free Smelter (and Refinery, for gold), or "CFS," Program designed to comply with the OECD Due Diligence Guidance by providing for reliable audits of smelters and refineries;[66] (2) the ITRI Tin Supply Chain Initiative ("ITSCi"), which tracks tin, tantalum, and tungsten mined in the Covered Countries;[67] (3) the Responsible Jewellery Council ("RJC"), which has adopted a chain-of-custody certification standard and related guidance for gold and platinum to help affected companies in the jewelry industry meet OECD due diligence standards;[68] (4) the International Conference on the Great Lakes Region of Central Africa ("ICGLR"), to which the DRC and other Covered Countries belong, which is working toward the creation of a certification system for cassiterite, coltan, wolframite, and gold that has been endorsed by the United Nations;[69] and (5) the World Gold Council's Conflict-free Gold Standard and related guidance for affected companies.[70]
- Identify your suppliers, advise them of your company's new Section 13(p) obligations, and ask whether any "conflict mineral" (defining them in accordance with the statute and SEC rules) is used in any product/component and/or other materials supplied directly or indirectly to your company by each supplier, distinguishing between newly extracted and recycled/scrap conflict minerals. If there are any conflict minerals in the supply chain, each supplier should be asked to name the smelter or refinery where such minerals originated and/or to work with sub-suppliers to identify each such smelter or refinery, and determine whether that smelter or refinery is or will be OECD-compliant (e.g., certified by the EICC-GeSI's CFS Program, which includes an independent audit of each smelter or refinery, as a reliable source of "DRC conflict-free" conflict minerals). Some good sample "Dear Supplier" letters, and tips on conducting this supplier inquiry process in a manner consistent with the OECD Due Diligence Guidance, are provided in a recent OECD progress report.[71]
- NOTE: When mapping its supply chain, a company that consults the pertinent OECD guidance and learns more about the various

initiatives being developed to provide affected companies with reasonable assurance under such guidance, should find it easier to design "reasonable country of origin inquiry" and "due diligence" mechanisms tailored to the company's individual facts and circumstances.

- Consider the need to amend existing supplier contracts, and include in new supplier contracts going forward, representations and warranties regarding the source of conflict minerals obtained from each relevant supplier.
- Consider the need to amend your company's ethics code, and otherwise to adopt a conflict minerals compliance policy, as such companies as General Electric, Intel, and others have done in anticipation of the final rules' effectiveness. Appropriate internal compliance procedures should be established, and employee training implemented.
- Identify conflict minerals eligible for exclusion because they are "outside the supply chain" on or before January 31, 2013.
- Update the company's disclosure controls and procedures to include the company's new Form SD filing/reporting obligation.
- Determine whether the company will need to engage an independent third party auditor for calendar 2013 and, if so, whether the Audit Committee should consider engaging the company's independent outside auditor to perform this permissible "non-audit service."

Disclosure of Governmental Resource Extraction Payments

In tandem with the new conflict minerals disclosure rules, the SEC adopted new Exchange Act Rule 13q-1 and an amendment to new Form SD (Part II of the Form; Part I was adopted as part of the conflict minerals rulemaking discussed above) pursuant to Section 1504 of the Dodd-Frank Act – which added a new Section 13(q) to the Exchange Act.[72] Under Section 13(q), the SEC's implementing Rule 13q-1 and the line-item requirements of Part II of Form SD, both US and non-US registrants that are "resource extraction issuers" (this defined term is discussed below) must disclose specified information annually regarding any non-*de minimis* payment (or series of payments) of $100,000 or more made during the reporting period to a foreign government, or to the US Federal Government, for the purpose of the "commercial development of oil, natural gas or minerals."

As was the case with Section 13(p), Congress in passing Section 13(q) was interested primarily in achieving a social policy objective tied to an ongoing, multi-nation initiative. As the SEC observed, "[a] primary goal of [Section 13(q)] … is to help empower citizens of … resource-rich countries to hold their governments accountable for the wealth generated by those resources" by giving them access to the information made publicly available via Form SD.[73] Section 13(q) itself states that the new resource extraction disclosure requirements are intended to support the US government's commitment to international transparency initiatives dedicated to fostering and improving transparency and accountability of resource-rich companies, referring specifically to one such voluntary global initiative in which the United States is participating – the Extractive Industries Transparency Initiative ("EITI").[74]

Consistent with the text of Section 13(q), the final rules require an affected company to disclose not only its own payments to specified governments for commercial development of oil, natural gas, or minerals, but also any such payments made by a "subsidiary" or other entity under the "control" of that company. For purposes of new Rule 13q-1 and Part II of Form SD, the relevant definitions of "subsidiary" and "control" are set forth in Exchange Act Rule 12b-2.[75] Because of the breadth of the regulatory definitions of "affiliate" and "control," an affected company may find that it must report payments made by joint ventures and/or equity investees whose financial results are not required to be consolidated with those of the company under applicable generally accepted accounting principles. In this regard, the SEC explained that, "[w]e … believe that a facts-and-circumstances definition of control consistent with the federal securities laws is preferable to a bright-line rule limiting disclosure to payments made only by consolidated entities because it is consistent with the statutory language [of Section 13(q)]."[76] Regardless of the existence of a "control" relationship between a resource extraction issuer and a third party, otherwise reportable payments made by such a third party to a government on behalf of the issuer must be reported via Form SD.

Before we discuss the Section 13(q) defined terms and the specifics of the new resource extraction payment disclosures called for by Part II of Form SD, a few preliminary observations are in order. Like the Form SD Part I disclosures relating to conflict minerals (including the Conflict Minerals Report filed as an exhibit, as necessary), the resource extraction payment disclosures required by Part II of the Form are deemed "filed," not "furnished," and thus are subject to Exchange Act Section 18 liability. However, the "filed" Form SD Part II disclosures (including those that must be presented in an XBRL-formatted exhibit, as discussed further below) will not be automatically incorporated by reference into other filings under the Securities Act and the Exchange Act (absent affirmative company action to do so).

By contrast with the Part I conflict minerals reporting obligation discussed above, the Part II Form SD reporting obligation is tied to a covered company's fiscal year-end, and must be filed no later than 150 days after the close of a company's fiscal year. The new rules apply to companies whose fiscal years end after September 30, 2013, with the first Part II Form SD report due no later than May 30, 2014 for companies with calendar fiscal years. A company whose fiscal year begins prior to September 30, 2013 is permitted to file a partial report limited to payments made during a "stub" period beginning October 1, 2013 and running through the end of its fiscal year. To illustrate how this "phase-in" works for a company with a calendar fiscal year, the 2013 report to be filed on or before May 30, 2014, would encompass payments made between October 1 through December 31, 2013. Resource extraction issuers whose fiscal years begin after September 30, 2013, must file a Part II Form SD covering a full fiscal year.[77]

Several key concepts embedded in the text of Section 13(q) – some of which the SEC declined to define in "bright-line" terms – are critical to understanding the scope of the new reporting obligation. Before addressing the specifics of what information must be reported by "resource extraction issuers" in an annual Form SD, we discuss each of these concepts immediately below.

What is a "Resource Extraction Issuer"?

Section 13(q), together with the final rules, defines the term "resource extraction issuer" to include all US and foreign companies, whether or not government-owned, that are: (1) engaged in the "commercial development of oil, natural gas, or minerals" (discussed below);

and (2) required to file annual reports with the SEC. There are no exemptions for smaller companies, companies without extensive resource-extraction business operations, or non-US companies that are subject to similar reporting requirements under home-country laws, listing rules or an EITI program.[78] Nor are there any exemptions for situations in which foreign law prohibits the prescribed disclosures, companies are bound by present or future contractual confidentiality provisions, or grounds otherwise exist for protecting commercially or competitively sensitive information against public disclosure.[79]

What Does "Commercial Development of Oil, Natural Gas, or Minerals" Mean?

The final rules define "commercial development" of oil, natural gas, or minerals to include the activities of exploration, extraction, processing, and export, or the acquisition of a license for any such activity. This definition is intended to capture only activities that are directly related to the commercial development of the covered resources (oil, natural gas, and minerals), and not to ancillary or preparatory activities. For example, the SEC would not consider a manufacturer of a product used in the commercial development of oil, natural gas, or minerals (e.g., a manufacturer of drill bits or other machinery used to extract oil) to be engaged in the commercial development of the particular resource.[80] In addition, the final rules do not include marketing or transportation (other than transportation for the purpose of exportation) in the list of activities covered by the definition of "commercial development."

The Resource Extraction Adopting Release provides illustrations of which activities are covered by the terms "extraction," "processing," and "export." "Extraction" includes the production of oil and natural gas as well as the extraction of minerals. "Processing" includes (a) field processing activities, such as the processing of gas to extract liquid hydrocarbons, the removal of impurities from natural gas after extraction and prior to transport through the pipeline, and the upgrading of bitumen and heavy oil, and (b) the crushing and processing of raw ore prior to the smelting phase. By the same token, "processing" does not include refining or smelting. "Export" includes the export of oil, natural gas, or minerals from the host country (recall that transportation activities are not "scoped" within the new rules unless undertaken in furtherance of export activities).

In a departure from the proposal, the SEC added an anti-evasion provision to the final rules. This provision requires disclosure with respect to an activity or payment that is part of a plan or scheme to evade the mandated disclosure requirements, even if the activity or payment does not fit neatly within one of the covered categories or is assigned a different classification by the company. Thus, a resource extraction issuer cannot avoid disclosure by re-characterizing an otherwise disclosable activity as "transportation" for purposes other than export, an activity that would not be covered under the final rules.[81]

What Does the Term "Payment" Mean?

Coverage under Section 13(q) and the final rules turns on whether a "payment" made to any specified government should be viewed, through the lens of EITI guidelines (to the extent practicable), as "part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals."[82] More specifically, a reportable "payment" includes any payment that:

- is made to a foreign government or the US Federal Government to further the commercial development of oil, natural gas, or minerals;

- is **not** *de minimis* (defined by the SEC as a payment or series of payments that equals or exceeds $100,000); and
- falls exclusively within one of the following payment types, all of which the SEC found to be consistent with EITI guidelines (as directed by Section 13(q), to the extent practicable):
  - taxes (including taxes on corporate profits, corporate income and production, **but not** taxes on consumption, personal income or sales);
  - royalties;
  - fees (including license, rental, entry and concession fees);
  - production entitlements;
  - bonuses (including signature, discovery, and production bonuses);
  - dividends (other than dividends paid to a government as a common or ordinary shareholder on the same terms as other shareholders); and
  - payments for infrastructure improvements, such as building a road or railway (**but not** including social or community payments, such as building a hospital or school).

The term "payment" also includes in-kind payments falling within the categories of payments identified above; one example cited by the SEC is a payment made to a government in the form of oil rather than cash. Resource extraction issuers may report such in-kind payments at cost or, if cost is not determinable, at fair market value. A brief description of how the monetary value was calculated also is required, as further explained below.

What is a "Project?": Mandatory Disclosure on a Project-by-Project Basis

The mandated disclosures (which are described below) must be made on a project-by-project basis. Although the final rules do not define the term "project" with any degree of specificity, given the SEC's stated preference for allowing affected companies some flexibility in this area, the Resource Extraction Adopting Release nevertheless does offer some useful guidance with respect to the meaning of the term. In the SEC's view, companies in the extractive industries routinely enter into contracts with governments for the purpose of commercial development of natural resources. Such a contract "defines the relationship and payment flows between the resource extraction issuer and the government and therefore, …generally provides a basis for determining the payments, and required payment disclosure, that would be associated with a particular 'project.'"[83] The SEC expressly rejected commentators' suggestions that the final rules incorporate a materiality standard or use a "reporting unit" approach borrowed from generally accepted accounting principles, having determined that Congressional intent to promote transparency and accountability did not permit application of such limiting principles.

The SEC was more receptive to arguments that affected companies should not be forced to disaggregate and allocate payments on a per-project basis if payment obligations are imposed by a particular government at the entity level. Recognizing that a company may have more than one project in a host country, and that such country's government may levy corporate income taxes on the company with respect to income earned in the country as a whole, and not with respect to a particular project, the final rules permit the company to disclose the resulting income tax payments without specifying a particular project associated with the payment.[84]

What is a "Foreign Government"?

In strict adherence to Section 13(q), the final rules define the term "foreign government" to include both a foreign national government and a subnational government, such as the government of a state, province, county, district, municipality, or territory under a foreign national government.[85] In addition, "foreign government" means a department, agency, or instrumentality of a foreign government, or a company that is majority-owned by a foreign government.

The term "Federal Government" is limited to United States Federal Government and therefore does not extend to state or local governments.[86] While acknowledging the disparate treatment of US and foreign governmental payments, the SEC noted that Congress made this choice as evidenced by the plain language of the statute.

Disclosure of Resource Extraction Payment Information – Form SD

To recapitulate the key elements of a resource extraction issuer's reporting obligation under Rule 13q-1, detailed information regarding covered payments made to foreign governments and the US Federal Government during a given fiscal year must be disclosed on a project-by-project basis in accordance with line-item requirements set forth in Part II of Form SD. This information must be presented in XBRL interactive data format in an exhibit (Exhibit 2.01) to Form SD, which must be filed via EDGAR no later than 150 days after the end of the resource extraction issuer's most recent fiscal year.[87] A brief statement must be included in Form SD directing investors to the exhibit for the more comprehensive, project-specific payment disclosures.

Item 2.01(a) of Form SD specifically requires a resource extraction issuer to disclose the following information in an exhibit to Form SD, formatted in XBRL, for a given reporting period (the preceding fiscal year, with stub-period reporting permitted in 2014 by affected issuers whose fiscal years begin prior to September 30, 2013). Payments by the issuer, any subsidiary, or entities controlled by the issuer, are captured by the Form. As you review these line-items, keep in mind the "not *de minimis*" payment threshold of $100,000, but also note that a series of related, smaller payments may take an issuer over that threshold:

- the type and total amount of payments made by the issuer for each project;
- the type and total amount of such payments made to each government;
- the total amounts of the payments by type (e.g., taxes, royalties, fees, production entitlements, bonuses, dividends and payments for infrastructure);
- the currency used to make the payments;
- the business segment of the issuer that made the payments;
- the government that received the payments, and the country in which the government is located; and
- the project of the resource extraction issuer to which the payments relate.

Instruction 3 to Form SD directs affected issuers to report the amount of payments for each payment type, and the total amount of payments made for each project and to each government, in either US dollars or the issuer's reporting currency. If the actual payments are made in currencies other than US dollars or the issuer's reporting currency, the issuer must convert such currencies to US dollars or the issuer's reporting currency using one of three methods specified in Instruction 3. Instruction 1 to the Form, as noted above, requires that in-kind payments be assigned a monetary value and reported in either US dollars or the issuer's reporting currency. Payment information need not be audited and may be reported on a cash rather than an accrual basis.[88]

What Should Affected Companies Consider Doing Now?

Companies potentially affected by Exchange Act Rule 13q-1 should proceed with a preliminary analysis of whether the new resource extraction payment disclosure requirements apply to them, whether directly or pursuant to the activities of subsidiaries and/or other "controlled" entities anywhere in the world. As discussed, there is no guarantee that the pending litigation challenging these requirements ultimately will be successful, and failure to comply by the May 30, 2014 filing deadline could lead eventually to SEC enforcement action if the final rules are not invalidated before that deadline.

Here are a few steps that SEC registrants that are engaged, even indirectly, in the commercial development of oil, natural gas, or minerals within or outside the United States, may wish to consider:

- Determine whether the company is a "resource extraction issuer," defined to mean any issuer required to file an annual report on Form 10-K, 20-F or 40-F[89] that engages in the "commercial development of oil, natural gas, or minerals" – which means exploration, extraction, processing, and export of any of these resources, or the acquisition of a license for any such activity. As part of this determination, the appropriate company personnel should evaluate whether any company subsidiary (whether or not consolidated), or an interest in a joint venture or other entity subject to the company's "control" (as this term is defined by Exchange Act Rule 12b-2), is or will engage in the reasonably near future in the any of these activities. In this connection, be aware that – in contrast with the new conflict minerals disclosure requirements – the SEC has not provided transition relief for those previously unaffected companies that acquire a "control" position in an entity that is engaged in any of the foregoing activities.
- Assuming the company is a "resource extraction issuer," consider what modifications should be made to the company's disclosure controls and procedures to "ensure that information disclosed by the issuer … [under Rule 13q-1 and Part II of Form SD] is recorded, processed, summarized and reported" on or before the initial "due" date, May 30, 2014. Exchange Act Rules 13a-15 and 15d-15 apply here, even though the CEO/CFO certifications mandated by Rules 13a-14 and 15d-14 do not (because, unlike the proposed rules, the final rules do not require that resource extraction payments be disclosed in the annual report on Form 10-K, 20-F, or 40-F). Establishing reliable, internally auditable systems for tracking non *de minimis* payments made worldwide on a project- and country-specific basis, by payment type, and for tagging the required information in accordance with the new XBRL taxonomy, will be critical to compliance with the new rules.
- Integrate this new disclosure duty into the company's existing compliance policies and procedures, including (but not limited to) those pertaining to the Foreign Corrupt Practices Act of 1977 ("FCPA"), the U.K.

Bribery Act, the new Iranian statutory sanctions discussed in the next section of this article, and any other global compliance provisions to which the company, or any subsidiary or other "controlled" entity, might be subject.

- Take steps to ensure that all interested persons, from the board of directors and senior management to other relevant employees of US and non-US business operations, understand the operation of the new rules and the company's policies and procedures for compliance with these rules. Appropriate training should be undertaken.
- Assess the possible impact of the company's resource extraction payment disclosure obligations on existing and future contracts and operations in certain jurisdictions, given the SEC's view that neither contractual confidentiality provisions (even those that lack the usual "compliance with applicable law" exceptions), nor applicable foreign laws barring disclosure, will justify non-compliance with Rule 13q-1 and Part II of Form SD. Moreover, the SEC has made clear that companies should expect staff denial of any request for confidential treatment of competitively sensitive information whose disclosure is otherwise called for by the new rules.

New Iran Sanctions Disclosure Requirements

Effective February 6, 2013, new Exchange Act Section 13(r) mandates disclosure, in annual and quarterly reports that are due after this date, of enumerated activities relating to Iran that occurred during the reporting period. More specifically, any US or non-US company "required" to file periodic reports under Section 13(a) of the Exchange Act[90] must disclose whether that company, or any of its affiliates located anywhere in the world, "knowingly"[91] engaged in certain business activities involving Iran that could subject the company to sanctions under US laws. There is no *de minimis* disclosure threshold; the statute in essence treats all covered activities as "material" for disclosure purposes, so long as these activities are conducted with the requisite intent.

According to SEC Staff interpretations published on December 4, 2012, the term "affiliate" as used in Section 13(r) has the same meaning as that set forth in Exchange Act Rule 12b-2.[92] As defined in Rule 12b-2, the term "affiliate" means "a person who directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." Another provision of Rule 12b-2 defines "control" as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." Because the SEC has declined repeatedly to adopt a bright-line test for determining "affiliate" status, companies will have to conduct a facts-and-circumstances analysis of a wide array of factors potentially indicative – alone or in combination – of a possible "control" relationship in a particular situation.[93] Such factors could include, but are not necessarily confined to, voting equity ownership of 10% or more, board representation, contractual rights, and/or any other mechanism for the exercise of actual or potential influence over the management of another entity or person.

For calendar-year registrants, this new disclosure duty will apply to the Form 10-K (or Form 20-F, in the case of foreign private issuers) for the fiscal year ended December 31, 2012. As previously discussed, the SEC Staff recently made clear that companies may not avoid this duty simply by filing early; that is, prior to the statutory effective date of February 6, 2013.[94] Moreover, according to the Staff, Section 13(r) operates retroactively in the case of the upcoming annual report on Form 10-K (or Form 20-F) for fiscal 2012, to capture activities that may have occurred prior to enactment of the Iran Threat Reduction Act on August 10, 2012. "For example, an issuer that files an annual report for the fiscal year ending December 31, 2012, is required to disclose any activities specified in Section 13(r)(1) that took place between January 1, 2012 and December 31, 2012."[95]

With respect to the notice the company must file concurrently with any annual or quarterly report containing the Iran-related disclosures required by Section 13(r), the SEC Staff recently announced that the agency is in the process of creating a new EDGAR form type called IRANNOTICE. Once EDGAR is modified to accommodate the filing of the notice, and the new form type is available for use – which the Staff now expects to occur on January 14, 2013 – affected companies must "prepare a separate document that includes the information required by the statute, convert it to ASCII or HTML as instructed by the EDGAR Filer Manual, and submit it using … [the] new EDGAR form type called IRANNOTICE." This notice will appear as part of the company's EDGAR filing history, along with the contemporaneously filed periodic report, and therefore will be searchable through the EDGAR system.[96]

What Iran-Related Activities Engaged in by the Company or an Affiliate Will Trigger a Section 13(r) Duty to Disclose in Connection with the Upcoming Annual Report on Form 10-K or Form 20-F?

Section 13(r) requires disclosure, in any annual or quarterly report due to be filed with the SEC after February 13, 2013, of certain information (discussed in the next section of this article) if the company or any of its affiliates knowingly engaged in any of the following activities or transactions during the period covered by that report:

- Significant investments in, or transactions contributing to the enhancement of, Iran's oil and gas industry, or that facilitate the development of weapons of mass destruction or other military capabilities, in contravention of Section 5(a) or Section 5(b) of the Iran Sanctions Act of 1996, as amended, respectively;[97]
- Activities or transactions described under certain provisions of Section 104 of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, as amended ("CISADA"), relating to foreign financial institutions that facilitate the Government of Iran's efforts to acquire or develop weapons of mass destruction, provide support for terrorism, engage in money laundering, and/or commit other specified violations (Sections 104(c)(2) and 104(d)(1) of CISADA);[98]
- Activities described in CISADA Section 105A(b)(2) (which was added to CISADA by the Iran Threat Reduction Act) relating to the transfer of goods (e.g., weapons) or technology, or services related to the foregoing, that are likely to be used by the Government of Iran to perpetrate human rights abuses against the people of Iran (e.g., surveillance hardware, software and/or related services);[99]
- Conducting any transaction or dealing with persons whose property or interests in property are blocked pursuant to Executive Order 13224 (terrorist activities or support thereof) or Executive Order 13382 ("proliferators" of weapons of mass destruction). Note that this provision is broad

enough to capture activities involving any country in the world, including but not limited to Iran;[100] or

- Conducting any transaction or dealing with the Government of Iran, as that term is broadly defined by the US Treasury Department's Office of Foreign Assets Control ("OFAC") in Section 560.304 of Title 31 of the Code of Federal Regulations (e.g., as the state and the Government of Iran, any political subdivision, agency or instrumentality thereof, and any entity owned or controlled by any of the foregoing), without the specific authorization of a US Federal department or agency.[101] The SEC Staff has published two interpretations relating to this provision of Section 13(r):
  - Disclosure must be made of any otherwise covered activity or transaction that was authorized by a foreign government, but not by the US government;[102] and
  - Both general and specific licenses issued by OFAC will be deemed to constitute "specific authorization of a US Federal department or agency" for purposes of Section 13(r), thus enabling a company to omit disclosure of conduct covered by such "specific authorization," but only if "all conditions of the applicable license are strictly observed."[103]

What Disclosure is Required Once a Section 13(r) Obligation is Triggered?

If any of the activities described above – whether undertaken by the company or an affiliate – occurred during the reporting period, the corresponding annual or quarterly report filed by the company with the SEC must include a detailed description of: (1) the nature and extent of the activity; (2) the gross revenues and net profits attributable to such activity, if any; and (3) whether the company or affiliate intends to continue engaging in the activity.[104] Conversely, if the company and its affiliates have *not* engaged in any of these activities, no disclosure is required.[105] Neither Section 13(r) nor the SEC Staff guidance specifies where the mandated information should appear in a given periodic report. One thing is clear, however – the Staff indicates that this information will be made public automatically upon the filing of the covered report, thus sending a strong signal that affected companies should not expect Staff grants of confidential treatment.[106]

Concurrently with the filing of a periodic report containing the disclosure prescribed by Section 13(r), the company must file a separate notice with the SEC indicating that the requisite disclosure has been included in that report.[107] Upon receipt of this notice, the SEC in turn must make publicly available, via posting on the agency's web site, both the notice and the relevant information contained in the covered report. (As explained above, the SEC will create a new EDGAR form type to satisfy this statutory obligation.) In addition, the SEC must "promptly" transmit the particular periodic report to the President and certain Congressional committees.[108] With one limited exception,[109] the President then must initiate an investigation and make a determination, within 180 days thereafter, as to whether sanctions should be imposed on the company or its affiliate (as the case may be).

Given the absence of any materiality threshold for disclosure and the obligation to monitor, with a view toward possible disclosure, even *de minimis* dealings of non-US affiliates, compliance with Section 13(r) is likely to demand significantly more time, effort and other resources from US and non-US reporting companies alike.[110] It may be particularly difficult to determine whether the Iranian government (including any instrumentality thereof) has a controlling interest in or derives profit from a business enterprise incorporated in a country other than Iran. And foreign private issuers may find themselves compelled to disclose business dealings with Iran that may not otherwise be subject to US anti-Iran sanctions, simply because they have a US stock exchange listing that gives rise to a periodic reporting duty under Section 13(a) of the Exchange Act.

What Should Companies Consider Doing Now?

- Companies should review their global operations for the entirety of calendar year 2012 (in light of the SEC Staff's guidance on retroactivity of Section 13(r) and its effect on 12/31/12 year-end registrants), to determine whether any of their activities, or the activities of any of their affiliates worldwide, might fall within the scope of the new disclosure requirement. In this regard, keep in mind that Section 13(r) has no materiality standard that otherwise might limit the nature and scope of disclosure.

- Because the Exchange Act "affiliate" concept applicable here is sufficiently broad to pick up non-consolidated joint ventures and other entities in which the company has a large minority equity stake or board representation (and/or other indicia of "control" as defined under Exchange Act Rule 12b-2 and discussed above), the company may find it necessary to evaluate the business activities of foreign equity investees. A reporting company's ignorance of a foreign affiliate's covered activities likely would not be sufficient to establish a defense to an SEC charge of a disclosure violation under Exchange Act Sections 13(a) and 13(r), inasmuch as Section 13(r)(1) by its terms extends in the alternative to enumerated activities "knowingly" engaged in by *either* the reporting company *or* any affiliate. Contractual rights of access to information regarding an affiliate's Iran-related activities may have to be negotiated, if such access otherwise is not available.

- In addition to the expansive disclosure duty imposed by Section 219 of the Iran Threat Reduction Act (adding new Section 13(r) to the Exchange Act), US companies should be aware that a separate provision of the Iran Threat Reduction Act – Section 218 – has expanded the US sanctions regime to encompass foreign subsidiaries that are wholly or majority-owned by a US company.[111] US companies therefore should update their compliance policies and procedures to prohibit non-US subsidiary business dealings involving the Government of Iran, which activities previously may have been permissible under US law. Conversely, registrants should remain mindful that Section 219 is far broader in scope than Section 218, in part because Section 219 (13(r)) applies to *all* registrants – including foreign private issuers that are *not* subject to Section 218 – and uses a much broader concept of "control" for purposes of the Exchange Act.

- Companies should review and update disclosure controls and procedures, if necessary, for quarterly (US registrants) and annual (US and non-US registrants), to ensure that any covered activities are identified and disclosed. Because the information prescribed by Section 13(r) must be disclosed in a periodic report, it will be subject to certification by the CEO and CFO under Exchange Act Rule 13a-14. It goes without saying that companies also may have to re-examine their ethics codes and other relevant compliance policies and procedures.

Conclusion

Given the recent battles on Capitol Hill over the demise of Bush-era tax breaks and the advent of deep cuts in government spending, the bipartisanship necessary to amend the federal securities laws to mandate the Dodd-Frank conflict minerals and resource extraction payments disclosures, as well as the Iran Threat Reduction Act disclosures of "sanctionable" activities involving the Government of Iran, seems all the more remarkable in hindsight (setting aside, for purposes of this article, the recently enacted JOBS Act focusing exclusively on small business capital formation and Exchange Act reporting, which also enjoyed bipartisan support). Whether or not the "social/foreign policy" objectives thus injected into the federal securities laws will be fulfilled remains to be seen. Though extremely laudable, these objectives might have been achieved more directly and effectively through other types of legislation. Congress nevertheless appears determined to harness a principle that the SEC recognized long ago in a rulemaking context – disclosure can affect corporate behavior, at least in the case of public companies. It is unclear whether application of this principle ultimately will serve the interests of the intended beneficiaries of the triad of amendments discussed in this article without capturing private companies that are not SEC registrants. Congress appeared to acknowledge the validity of this concern in charging the Comptroller General of the United States with reporting to the "appropriate congressional committees" periodically on whether Exchange Act Section 13(p) is effective in promoting peace and security in the Covered Countries (DRC and adjoining countries), and addressing in these reports whether non-SEC registrants also should be covered.[112] At the end of the day, such considerations are largely academic from the perspective of public companies facing an ever-increasing reporting burden with respect to matters that, while critically important, may not be of interest to the majority of their shareholders.

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1 Conflict Minerals, SEC Rel. No. 34-67716 (Aug. 22, 2012) ("Conflict Minerals Adopting Release"), at 6-7, [77 FR 56273], *available at* http://www.sec.gov/rules/2012/34-67716.pdf. "To accomplish the goal of helping end the human rights abuses in the DRC caused by the [ongoing armed] conflict, Congress chose to use the securities laws disclosure requirements to bring greater public awareness of the source of issuers' conflict minerals and to promote the exercise of due diligence on conflict minerals supply chains…. [, in an] attempt to inhibit the ability of armed groups in the Covered Countries [the DRC and adjoining countries, identified below in note 7] to fund their activities by exploiting the trade in conflict minerals." *Id.* at 8. *See also* Division of Corporation Finance, Conflict Minerals Disclosure – A Small Entity Compliance Guide (Nov. 2012), *available at* http://www.sec.gov/info/smallbus/secg/conflict-minerals-disclosure-small-entity-compliance-guide.htm.

2 Disclosure of Payments by Resource Extraction Issuers, SEC Rel. No. 34-67717 (Aug. 22, 2012) ("Resource Extraction Adopting Release"), at 5-6 (footnote omitted), [77 FR 56365], *available at* http://www.sec.gov/rules/final/2012/34-67177.pdf. *See also* Disclosure of Payments by Resource Extraction Issuers – A Small Entity Compliance Guide, *available at* http://www.sec.gov/smallbus/secg/resource-extraction-small-entity-compliance-guide.htm. A third "specialized disclosure" requirement relating to the safety of mines located in the United States, which is set forth in Section 1503 of the Dodd-Frank Act, was implemented by final Commission rule in late 2011. *See* Mine Safety Disclosure, SEC Rel. No. 33-9286 (Dec. 21, 2011), [76 FR

81762], *available at* http://www.sec.gov/rules/final/2011/33-9286.pdf.

3 *See* National Ass'n of Manufacturers, Chamber of Commerce of the United States of America, Business Roundtable v. Securities and Exchange Commission, Amended Petition for Review, USCA Case No. 12-1422 (D.C. Cir., filed Oct. 22, 2012) (asking the US Court of Appeals for the D.C. Circuit to review the new conflict minerals disclosure rule, and either modify or set this rule aside in whole or in part); American Petroleum Institute, Chamber of Commerce of the United States of America, Independent Petroleum Association of America, National Foreign Trade Council v. Securities and Exchange Commission, Complaint and Emergency Motion of Petitioner to Determine Jurisdiction filed, respectively, with the US District Court for the District of Columbia (Case 1:12-cv-1668-JDB), and the US Court of Appeals for the D.C. Circuit (USCA Case No. 12-1398), on October 15, 2012 (challenging the new resource extraction payments disclosure rule as fatally deficient under the First Amendment of the Constitution, the Administrative Procedures Act, and the Securities Exchange Act of 1934, as amended). As of early January 2013, the status of these cases is as follows: (a) an expedited briefing schedule has been established in the conflict minerals case now pending in the US Court of Appeals for the D.C. Circuit; and (b) after the SEC declined to stay implementation of the final resource extraction payment disclosure rules, the US District Court for the District of Columbia stayed the case filed there pending the D.C. Circuit's disposition of the petition for review filed concurrently with the higher court; the SEC filed a brief in the D.C. Circuit on January 2, 2013.

4 By contrast with the "enabling" provision of the Dodd-Frank Act (Section 971) that authorized, but did not require, the SEC to adopt a federal proxy access rule – a rule which, once adopted by the SEC, ultimately was stricken by the US Court of Appeals for the D.C. Circuit (in *Business Roundtable v. SEC*, 647 F. 3d 1144 (D.C. Cir. 2011)) – the statutory language of each of Sections 1502 and 1504 is highly prescriptive, and seemingly indifferent to any consideration of the regulatory costs that ultimately would be borne by affected companies (with the exception of the *de minimis* threshold embedded in Section 1504, which is addressed beginning on page 14 of this article). Moreover, neither statutory provision gives the agency express exemptive authority, raising serious questions regarding the extent to which the SEC legitimately could have invoked its general statutory exemptive power (conferred by Section 36 of the Exchange Act) – had it chosen to do so – to cut back on the highly detailed Congressional mandates set forth in both Sections 1502 and 1504, in order to reduce costs and other burdens imposed by statute on affected public companies.

5 *See* SEC Division of Corporation Finance Compliance and Disclosure Interpretations: Exchange Act Sections, Section 147 (as amended Dec. 4, 2012) ("Iran C&DIs"), *available at* http://www.sec.gov/divisions/corpfin/guidance/exchangeactsections-interps.htm.

6 Conflict Minerals Adopting Release at 309.

7 Countries "adjoining" the DRC, defined in Section 1502(e)(1) of the Dodd-Frank Act to mean any "country that shares an internationally recognized border with" the DRC, currently include Angola, Burundi, Central African Republic, the Republic of the Congo, Rwanda, South Sudan, Tanzania, Uganda and Zambia. *See* Conflict Minerals Adopting Release at 6 n.7.

8 *See* SEC Rel. No. 34-63547 (Dec. 15, 2010) ("Conflict Minerals Proposing Release"), [75 FR 80,948], *available at* http://www.sec.gov/rule/proposed/2010/34-63547.pdf.

9 *See supra* note 1 and accompanying text.

10 Issuers filing Exchange Act reports under either Section 13(a) or Section 15(d) are covered; registered investment companies are not. Because there is no reference in either the statute or final rules to issuers "required" to report under the Exchange Act, it would appear that so-called "voluntary" filers must comply.

11 Exchange Act Rule 13p-1.

12 Part II of Form SD is dedicated to disclosure by "resource extraction issuers" under Exchange Act Section 13(q) and Rule 13q-1, which is addressed in the next section of this article.

13 The term “smaller reporting company” is defined in Rule 12b-2 under the Exchange Act.

14 Sections 101(a) and (b) of the JOBS Act of 2012, adding, respectively, Section 2(a)(19) to the Securities Act of 1933, as amended (“Securities Act”), and Section 3(a)(80) to the Exchange Act.

15 Conflict Minerals Adopting Release at 21.

16 *See* Rule 13p-1 and Item 1.01(d)(3) of Form SD. The Secretary of State can designate additional conflict minerals by making a determination that any other minerals or their derivatives are financing conflict in the Covered Countries. *See* Conflict Minerals Adopting Release at 40.

17 Item 1.01(d)(7) and Instruction 4 to Item 1.01 of Form SD.

18 Conflict Minerals Adopting Release at 129.

19 *Id.* at 60. *See* Instruction 1 to Item 1.01 of Form SD. However, mining companies still may be subject to the resource extraction payments disclosure requirements imposed via SEC rulemaking under Section 1504 of the Dodd-Frank Act, discussed later in this article.

20 The SEC stated in the Conflict Minerals Adopting Release (at p. 63) that “the phrase ‘contract to manufacture’ captures manufacturers that contract the manufacturing of components of their products.” In the SEC’s view, “manufacturing issuers that contract the manufacturing of certain components of their products should, for purposes of … [Section 13(p)], be viewed as responsible for the conflict minerals in those products to the same extent as if they manufactured the components themselves.” *Id*.

21 *Id.* at 65.

22 *Id.*

23 *Id.* at 84-85 (construing the plain language of the statute).

24 *Id.* at 86.

25 The SEC found persuasive in this regard both the absence of a *de minimis* threshold in Section 13(p) itself, a threshold that Congress did choose to include in new Section 13(q), and the State Department’s views regarding Congressional intent. *See* Conflict Minerals Adopting Release at 92-93.

26 *Id.* at 82.

27 *Id.* at 89-91.

28 This formulation represents a major shift from the proposed rules, which would have compelled the filing of a Conflict Minerals Report pursuant to Step Three unless the registrant could prove a negative; i.e. that its conflict minerals *did not* originate in the Covered Countries. *See* Conflict Minerals Adopting Release at 151.

29 *Id.* at 148-149. As the Commission noted, this approach is consistent with the OECD’s due diligence guidance that underpins the analysis required by Step Three under the final rules, and is discussed further in the text of this article. More specifically, the Commission observed that the reasonable country of origin inquiry constitutes “the first step issuers must take under the OECD guidance to determine if the further work outlined in the OECD guidance – due diligence – is necessary.” *Id.* at 150.

30 *Id.* at 153 n.455.

31 *Id.* at 153-54 & n.456.

32 *Id.* at 148-50.

33 *Id.* at 120. Commentators had argued that a uniform reporting period would be less burdensome for supply chain participants, particularly those that produce components for manufacturers with divergent fiscal year ends. *Id*.

34 Instruction 5 to Item 1.01, Form SD.

35 Conflict Minerals Adopting Release at 121.

36 *See* Instruction 3 to Item 1.01, Form SD.

37 Conflict Minerals Adopting Release at 117.

38 *Id.* at 117 & n.342.

39 *See* Item 1.01(b), Form SD. In a departure from the proposed rules, the Commission decided not to require companies to preserve “reviewable business records” to support the disclosure made in Form SD. As discussed further below, however, affected companies nevertheless should adapt

their existing disclosure controls and procedures to enable them to comply with the new rules, and be prepared to offer documentary proof of compliance in the event of an SEC enforcement investigation/action (whether predicated on violations of Sections 13(a) or 15(d) and 13(p) and/or the antifraud provisions of the federal securities laws, or private antifraud litigation).

40 Item 1.01(c), Form SD. The SEC has codified the OECD definition of "recycled and scrap sources" in the final rules: "Conflict minerals are considered to be from recycled or scrap sources if they are from recycled metals, which are reclaimed end-user or post-consumer products, or scrap processed metals created during product manufacturing. Recycled metal includes excess, obsolete, defective and scrap metals that contain refined or processed metals that are appropriate to recycle in the production of tin, tantalum, tungsten and/or gold. Minerals partially processed, unprocessed, or a bi-product from another ore will not be included in the definition of recycled metal." Item 1.01(d)(6), Form SD; *see* Conflict Minerals Adopting Release at 230-32.

41 Items 1.01(c)(1)(i) & (ii), Form SD.

42 Item 1.01(c), Form SD. The registrant also must disclose this information on its website, and include a link thereto in the Form SD.

43 Item 1.01(c), Form SD.

44 Items 1.01(d)(2) and 1.01(d)(4), Form SD.

45 Item 1.01(d)(4), Form SD.

46 Instruction 5 to Item 1.01, Form SD.

47 Exchange Act Section 13(p)(1)(C).

48 Published in 2011, this guidance can be found on the OECD's website at http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/46740847.pdf. The OECD Due Diligence Guidance includes supplements focusing on each of the "3Ts" (tin, tantalum, and tungsten); a separate gold supplement was published in 2012. *See* OECD, "Due Diligence Guidance for Responsible Supply Chains of Minerals From Conflict-Affected Areas and High-Risk Areas: Supplement on Gold (2012) ("OECD Gold Supplement"), *available at* http://www.oecd.org/corporate/guidelinesformultinationalenterprises/FINAL%20Supplement%20on%20Gold.pdf.

49 Conflict Minerals Adopting Release at 206 (citation omitted).

50 *See* Item 1.01(c)(1)(ii)(A), Form SD. As the SEC observed in the Conflict Minerals Adopting Release (at 217-18), the audit does not extend to the entire Conflict Minerals Report – just to those "sections of the Conflict Minerals Report that discuss the design of the issuer's due diligence framework and the due diligence measures the issuer performed …." While the SEC recognized that the audit objective adopted "differs significantly from the objectives of other audits required by our rules," both the statutory structure and cost concerns raised by commentators warranted a more limited audit objective. *Id.* at 218.

51 According to the SEC, the GAO staff has advised that existing GAGAS standards governing Attestation Engagements or Performance Audits will apply to the audit called for by the final rules. This gives a company the flexibility to engage either its own independent registered public accounting firm or another such firm (if an Attestation Engagement is desired, it must be performed by a licensed certified public accounting firm), or a non-accountant subject-matter expert (if the company opts for a Performance Audit, which need not be performed by a certified public accountant). *See* Conflict Minerals Adopting Release at 214-15.

52 *Id.* at 215-16. Such an engagement would be considered a "non-audit service" subject to the Audit Committee pre-approval requirements of Rule 2-01(c)(7) of Regulation S-X, and the dollar amount of the fees paid relating to the conflict minerals audit must be reported in the "All Other Fees" category of the principal accountant fee disclosures in the company's proxy statement. *See id.* at 216. Regardless of whether the independent private-sector auditor is a PCAOB-registered public accounting firm, the "entities performing an independent private-sector audit of the Conflict Minerals Report must comply with any independence standards established by the

GAO, and any questions regarding applicability of GAGAS on this point should be directed to the GAO." *Id.* at 215. In addition, the SEC observed that the GAO's independence standard is NOT the same as the OECD's independence requirement for auditors retained to audit conflict minerals smelters. *See id.*; *see also* note 55, *infra*.

53 *See* Items 1.01(c)(1)(ii)(B) and (C), Form SD.

54 Conflict Minerals Adopting Release at 183.

55 Step Four of the OECD's five-step Due Diligence Guidance calls on companies to carry out an independent third-party audit of smelters' due diligence practices, either directly, or indirectly via industry processes. A recent progress report commissioned by the OECD, focusing on that organization's downstream implementation pilot project for the 3Ts, found that most pilot participants (a total of 26 companies and three industry organizations) are testing the reliability of a "Conflict-Free Smelter" Program (itself still in the pilot stage) developed by an industry coalition enrolled in the OECD pilot, known as the EICC-GeSI (Electronic Industry Citizenship Coalition and Global e-Sustainability Initiative) Work Group, to verify the consistency of smelter due diligence mechanisms with the OECD due diligence framework. *See* OECD, "Downstream Implementation of the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: Cycle 2 Interim Progress Report on the Supplement on Tin, Tantalum and Tungsten" (June 2012) ("OECD Interim Progress Report") at 31-32, *available at* http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/DownstreamCycle2Report.pdf.

56 *See supra* note 40 for the definition of "recycled or scrap sources."

57 *See supra* note 48.

58 The SEC explains (in the Conflict Minerals Adopting Release at 233-34) how companies should incorporate, into their diligence practices and related disclosures in the Conflict Minerals Report, any future due diligence framework that ultimately may be developed for any of the "3Ts" derived from recycled/scrap materials.

59 For all issuers, this alternative is available during the first two reporting cycles after the November 2012 effective date of the final rules, which means calendar years 2013 and 2014. Smaller reporting issuers may elect a longer grace period consisting of the first four reporting cycles after the effective date, or calendar years 2013 through 2016. *See* Conflict Minerals Adopting Release at 188; Instruction 2 to Item 1.01, Form SD.

60 Item 1.01(d)(5), Form SD; Instruction 2 to Item 1.01, Form SD.

61 Conflict Minerals Adopting Release at 186.

62 *Id.* at 189 & n.156 (offering alternative formulations that would be deemed appropriate, depending on the particular facts and circumstances).

63 In the United States, for example, California and Maryland have passed laws barring state governmental contracting with companies that fail to comply with the disclosure requirements of Section 1502 of the Dodd-Frank Act and the SEC's implementing rules. *See* CAL. PUB. CONT. CODE § 10490 (West through 2012 Session); MD CODE ANN., STATE FIN. AND PROC. § 14-413 (LEXIS through 2012 Session). Outside the United States, the European Commission expressed support in early 2012 for the OECD's Due Diligence Guidance. *See* Communication from the European Commission to the European Parliament, the Council and the European Economic and Social Committee, *Trade, growth and development: Tailoring trade and investment policy for those countries most in need* (Jan. 2012) at 15, *available at* http://trade.ec.europa.eu/doclib/docs/2012/january/tradoc_148992.EN.pdf.

64 *See* OECD Interim Progress Report at 5-6 (discussing pilot).

65 *See* Remarks of Robert D. Hormats, Under Secretary for Economic, Energy and Agricultural Affairs, US State Department, delivered to the US Institute of Peace (Wash. D.C., Nov. 15, 2011), *available at* http//www.state/gov/e/rls/rmk/2011/177644.htm; Public-Private Alliance for Responsible Minerals Trade website, at www.resolv.org/site-ppa/.

66 *See* EICC-GeSI Conflict-Free Smelter (CFS) Assessment Program Frequently Asked Questions (Mar. 30, 2012), *available at* http://www.conflictfreesmelter.org/documents/conflict-free-smelterfaq.pdf. *See also supra* note 55 and accompanying text.

67 *See* ITSCi Project Overview, ITRI, http://www.itri.cp.uk/index.php?option=com_zoo&view=item&Itemid=189.

68 *See* RJC Chain-of-Custody Certification, *available at* http://www.responsiblejewellry.com/chain-of-custody-certification/.

69 *See* ICGLR Regional Initiative Against the Illegal Exploitation of Natural Resources (RINR), https://www.icglr.org/spip.php?article94.

70 The standard itself, and related information, is posted on the World Gold Council's website at http://www.gold.org/about_gold/sustainability/conflict_free_standard.

71 OECD Interim Progress Report at 11-17.

72 *See* Resource Extraction Adopting Release.

73 *Id.* at 6 n.7 (citations omitted).

74 *Id.* at 7-9. While Section 13(q) states only that the SEC rules defining "payment" must be consistent, to the extent practicable, with the EITI definition, the SEC refers to EITI throughout the Resource Extraction Adopting Release, and explains the need for deviation therefrom where appropriate. The EITI is a voluntary coalition of oil, natural gas and mining companies, various governments, investor groups, and other like-minded organizations. As explained in the Resource Extraction Adopting Release (at 8 n.14), President Obama announced in September 2011 that the United States would join this coalition; the US Department of the Interior is responsible for implementing the US EITI. Elsewhere in this Release, the SEC observed that the "United States is one of several countries that supports the EITI," and that Congress considered EITI in passing Section 13(q). *Id.* at 8-9.

75 Exchange Act Rule 12b-2 defines the term "subsidiary" to mean "an affiliate controlled by such person [i.e. the issuer], directly or indirectly through one or more intermediaries. The term "control," as defined in Rule 12b-2, means "the possession, direct or indirect, of the power to direct or cause the direction of the management of a person, whether through the ownership of voting securities, by contract, or otherwise." Finally, an "affiliate" is defined as "a person that directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, the person specified." Rule 12b-2.

76 Resource Extraction Adopting Release at 94-95.

77 *See* Section II.G.3. of the Resource Extraction Adopting Release.

78 The SEC noted that, as of August 15, 2012, only 14 countries – not including the United States – are considered "EITI-compliant," while 22 others are candidates and the United States is at an earlier stage of implementation. *Id.* at 7 n.14.

79 *Id.* at 28-29.

80 *Id.* at 43.

81 *Id.* at 46-47.

82 *Id.* at 59.

83 *Id.* at 86.

84 *Id.* at 88.

85 *See* Item 2.01(c)(2), Form SD.

86 Resource Extraction Adopting Release at 100-101.

87 The SEC acknowledged (*id.* at 121-122) that the XBRL taxonomy for tagging the requisite payment information is not yet available, but noted that the Staff had been working on this taxonomy and the agency expected to issue it "soon" for public comment. The Form SD draft taxonomy was issued a week after a majority of the SEC voted to adopt the final rules, and can be found on the SEC's website at http://www.sec.gov/infor/edgar/edgartaxonomies_d.shtml. Given this, and the extended implementation period

(discussed in Section II.G.3. of the Resource Extraction Adopting Release), the SEC concluded that further delay of the compliance date to permit development of the necessary taxonomy was not warranted.

88 Resource Extraction Adopting Release at 124 (footnote omitted)(explaining "that not requiring the payment information to be audited or provided on an accrual basis is consistent with Section 13(q) because the statute refers to payments and does not require the information to be included in the financial statements.")

89 Because Section 13(q) refers to issuers *required* to file an annual report with the SEC, it is unclear whether companies that file such reports on a voluntary basis will be expected by the SEC Staff to comply with the new rules.

90 Section 13(r)'s specific reference to Section 13(a) of the Exchange Act, in defining covered registrants, would seem to exclude companies that file periodic reports solely because they have made a registered public offering of securities giving rise to a reporting obligation under Section 15(d) of the Exchange Act. Neither the SEC nor its Staff has addressed the issue to date.

91 As defined in Section 2 of the Iran Threat Reduction Act (which incorporates the definition contained in Section 14 of the Iran Sanctions Act of 1996, as amended), the term "knowingly" means that a person had actual knowledge, or should have known, of the conduct, circumstance or result.

92 Iran C&DIs, Section 147, Question 147.03. *See supra* notes 75-76 and accompanying text.

93 The broad and amorphous concept of "affiliate" applicable under the Exchange Act is in sharp contrast to the comparatively narrow definition of the phrase "own or control" codified in Section 218(a)(2) of the Iran Threat Reduction Act: either to (a) hold more than 50% of the equity interest, by vote or value, in an entity; (b) hold a majority of the seats on that entity's board of directors; or (c) otherwise control the actions, policies or personnel decisions of that entity. Section 218 requires the President of the United States to bar foreign entities owned or controlled by a US person from knowingly engaging in activities involving Iran that would be illegal if engaged in by a US person (or in the United States), and authorizes the imposition of penalties on such US person. On October 9, 2012, President Obama issued an executive order that, among other things, implements Section 218. *See* Executive Order No. 13628 (Oct. 9, 2012), *available at* http://whitehouse.gov/the-press-office/2012/10/09/executive-order-president-regarding-authorizing-implementation-certain-s.

94 *Id.*, Question 147.01.

95 *Id.*, Question 147.02.

96 US Securities and Exchange Commission, Division of Corporation Finance, Notice required by the Iran Threat Reduction and Syria Human Rights Act of 2012 to be filed through EDGAR (Dec. 19, 2012), *available at* http://www.sec.gov/divisions/corpfin/cfannouncements/itr-act2012.htm.

97 *See* Section 13(r)(1)(A).

98 *See* Section 13(r)(1)(B).

99 *See* Section 13(r)(1)(c).

100 *See* Sections 13(r)(1)(D)(i) and (ii).

101 *See* Section 13(r)(1)(D)(iii).

102 *See* Iran CD&Is, Section 147, Question 147.05.

103 *Id.*, Question 147.06. This interpretation acknowledges the distinction between "specific" and "general" licenses, as explained by OFAC (in OFAC's Frequently Asked Questions and Answers, #74, *available at* http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx#60), while stating that both types of licenses will "count as a 'specific authorization of a Federal department or agency' for purposes of Section 13(r)(1)(D)(iii)."

104 *See* Section 13(r)(2).

105 Iran CD&Is, Section 147, Question 147.04.

106 *See id.*, Question 147.07.

107 *See* Section 13(r)(3).

108 *See* Section 13(r)(4).

109 *See* Section 13(r)(5) (the exception is for disclosures relating to knowingly conducting any transaction with the Government of Iran within the scope of Section 13(r)(1)(D)(iii)).

110 To date, companies that have received SEC Staff comments inquiring about the need to disclose business activities in or involving Iran, or any other country designated by the US State Department as a "State Sponsor of Terrorism" (in addition to Iran, these are Cuba, Sudan, and Syria), would be given an opportunity to argue that such business is or was immaterial and therefore not subject to disclosure on Exchange Act Rule 12b-20 grounds.

111 *See supra* note 93. There is a narrow window of opportunity for divestiture or termination of business with foreign entities "owned or controlled" by a US person, which will close on February 6, 2013. *See* Section 218(d).

112 *See* Section 1502(d)(2) of the Dodd-Frank Act.

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