SEC Proposes Rules for Specialized Disclosure Relating to Conflict Minerals, Mine Safety and Payments By Resource Extraction Issuers

On December 15, 2010, the Securities and Exchange Commission (the "SEC") issued three separate releases[1] in which it proposed rules to implement Sections 1502, 1503 and 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2] Sections 1502, 1503 and 1504 set forth special disclosure requirements relating to (1) conflict minerals originating in the Democratic Republic of the Congo or adjoining countries, (2) mine safety and (3) payments by resource extraction issuers, respectively. The SEC's proposed rules would apply to issuers who are required to file reports with the SEC under the Securities Exchange Act of 1934.

I. Conflict Minerals

Under Section 1502 of the Dodd-Frank Act, the SEC is required to adopt regulations for the annual disclosure by certain issuers that use "conflict minerals" originating in the Democratic Republic of the Congo (the "DRC") or adjoining countries (together, the "DRC countries") in the products they manufacture or contract to manufacture. "Conflict minerals" is defined as columbite-tantalite (coltan), casserite, gold, wolframite, or their derivatives, or any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the DRC countries.[3] These minerals are used in the manufacture of a number of products, including mobile telephones, computers, videogame consoles, digital cameras, jewelry and aerospace equipment. Under the SEC's proposed rule, if an issuer uses conflict minerals originating in a DRC country and those minerals are necessary to the functionality or production of a product it manufactures, that issuer would be required to file a report with the SEC describing, among other things, the measures it has taken to exercise due diligence on the source and chain of custody of the conflict minerals.

The SEC's proposed rule divides the disclosure requirements created by Section 1502 of the Dodd-Frank Act into three steps. Only issuers advancing to the third step would be required to file a full conflict minerals report with the SEC.

The first step establishes whether or not an issuer is subject to the disclosure requirements for conflict minerals. An issuer must determine whether conflict minerals are "necessary to the functionality or production of a product manufactured, or contracted to be manufactured," by such issuer.[4] Companies that mine conflict minerals are considered to be manufacturing these minerals and thus, would be subject to the rule's disclosure requirements. Public company retailers who contract to have products manufactured under their own private label would also be subject to the rule's disclosure requirements. The SEC, however, does not define what is "necessary to the functionality or production of a product," noting that if a mineral is necessary, the product would be covered regardless of the amount of mineral involved.

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1 *Conflict Minerals*, Release No. 34-63547 (Dec. 15, 2010), available at http://www.sec.gov/rules/proposed/2010/34-63547.pdf ("Conflict Minerals Release"); *Mine Safety Disclosure*, Release Nos. 33-9164; 34-63548 (Dec. 15, 2010), available at http://www.sec.gov/rules/proposed/2010/33-9164.pdf; *Disclosure of Payments by Resource Extraction Issuers*, Release No. 34-63549 (Dec. 15, 2010), available at http://www.sec.gov/rules/proposed/2010/34-63549.pdf ("Resource Extraction Release").

2 The Dodd-Frank Act is available at http://www.govtrack.us/congress/billtext.xpd?bill=h111-4173.

3 Conflict Minerals Release at 11.

4 *Id*. at 19.

Once an issuer has determined that it is subject to the disclosure requirements for conflict minerals, it must then determine whether any of the conflict minerals necessary to its product's functionality or production originate in a DRC country. An issuer determines this by performing a reasonable country of origin inquiry. The SEC does not set forth what a reasonable country of origin inquiry entails. However, in its proposing release, the SEC states it "would view an issuer as satisfying the reasonable country of origin inquiry standard if [the issuer] received reasonably reliable representations from the facility at which its conflict minerals were processed that those conflict minerals did or did not originate in the DRC countries."[5] The issuer would also have to look at the facts and circumstances to determine whether the facility's representations were true. If, after a reasonable country of origin inquiry, an issuer concludes its conflict minerals did not originate in a DRC country, that issuer would be required to disclose its conclusion annually on its website and in the body of its annual report with a description of how it arrived at its conclusion. The issuer would also be required to maintain "reviewable business records" to support its determination.

If, after a reasonable country of origin inquiry, the issuer determines that any of its conflict minerals originate in a DRC country, or if it is unable to determine whether any of its conflict minerals originate in a DRC country, the proposed rule would require the issuer to disclose this conclusion on its website and in its annual report. In addition, the issuer would be required to include a conflict minerals report as an exhibit to its annual report and on its website. The report must include a "description of the measures taken by the registrant to exercise due diligence on the source and chain of custody of the conflict minerals." Because "conduct undertaken by a reasonably prudent person may vary and evolve over time" the proposed rule does not provide specific guidance on the due diligence to be exercised.[6] In addition, the report must also contain an independent private sector audit of the report, and include a description of the products that are not "DRC conflict free," the facilities used to process the minerals, the country of origin of the conflict minerals, and the issuer's efforts to determine the mine or location of origin "with the greatest possible specificity."[7]

Additionally, the proposed rule would set forth different requirements for conflict minerals found in recycled or scrap sources due to the difficulty of tracing the supply chain of minerals from these sources. Rather than exercising due diligence on the source or chain of custody, as described above, the proposed rule would require the issuer to conduct a due diligence investigation to determine that the conflict minerals came from recycled or scrap sources. Conflict minerals from recycled or scrap sources would be deemed "DRC conflict free" and thus, not subject to the expanded disclosure described above. However, the issuer would be required to furnish a conflict minerals report, in which it describes the due diligence exercised in reaching its determination.

II. Mine Safety Disclosure

Section 1503 of the Dodd-Frank Act sets forth disclosure requirements for reporting issuers that are operators (or have a subsidiary that is an operator) of a coal or other mine located in the United States. The disclosure requirements in Section 1503 are currently in effect under the Federal Mine Safety and Health Act of 1977 (the "Mine Act"), which is administered by the Mine Safety and Health Administration ("MSHA"). Section 1503 authorizes the SEC to "issue such rules and regulations as necessary or appropriate for the protection of investors."[8] Thus, the SEC has proposed rules to define the scope and application of the mine safety disclosure

5 *Id*. at 38

6 *Id*. at 56

7 *Id*. at 42.

8 Dodd-Frank Act, Sec. 1503(d)(2).

requirements of Section 1503 and to require certain additional disclosures in Forms 10-K, 10-Q, 20-F and 40-F and in current reports on Form 8-K. The proposed rule would require the following items, which are also enumerated in Section 1503, to be disclosed in an issuer's periodic reports:

- For each coal or other mine, identification of the mine and disclosure of:

  The total number of violations of mandatory health or safety standards that could significantly and substantially contribute to the cause and effect of a coal or other mine safety or health hazard under Section 104 of the Mine Act for which the operator received a citation from MSHA;

  The total number of orders issued under Section 104(b) of the Mine Act;

  The total number of citations and orders for unwarrantable failure of the mine operator to comply with mandatory health or safety standards under Section 104(d) of the Mine Act;

  The total number of flagrant violations under Section 11(b)(2) of the Mine Act;

  The total number of imminent danger orders issued under Section 107(a) of the Mine Act;

  The total dollar value of proposed assessments from MSHA under the Mine Act; and

  The total number of mining-related fatalities.

- A list of coal or other mines, of which the issuer or subsidiary of the issuer is an operator, that receive written notice from MSHA:

  A pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under Section 104(e) of the Mine Act; or

  The potential to have such a pattern.

- Any pending legal action before the Federal Mine Safety and Health Review Commission involving such coal or other mine.[9]

In addition to the above disclosures, the proposed rule would also require the issuer to provide a brief description of each category of violations, orders and citations reported.

Under the proposed rule, if an issuer receives an imminent danger order or written notice from MSHA of a pattern or potential to have a pattern of violations of mandatory health or safety standards, the issuer would be required to file a Form 8-K within four business days of receipt of the notice or order. Disclosure in the Form 8-K would include the date of receipt of the order or notice, a brief description of the order or notice and identification of the mine involved. Although disclosed in an Form 8-K, these orders and notices must also be disclosed in the issuer's annual reports as set forth above.

[9] Dodd-Frank Act, Sec. 1503(a)(1), (2) and (3).

Notwithstanding the new Form 8-K disclosure requirement, the SEC has also proposed amending Form S-3 to add the new Form 8-K item to the list of Form 8-K items the untimely filing of which will not result in loss of Form S-3 eligibility.

III. Disclosure of Payments by Resource Extraction Issuers

Section 1504 of the Dodd-Frank Act requires the SEC to adopt rules requiring specialized disclosure for resource extraction issuers. The SEC's proposed rule would require a resource extraction issuer (or a subsidiary of the issuer or entity under the control of the issuer) to disclose payments made to a foreign government or the U.S. federal government for the purpose of the commercial development of oil, natural gas or minerals. The SEC defines "resource extraction issuer" as an issuer that is required to file an annual report with the SEC and engages in the commercial development of oil, natural gas, or minerals.[10] It also specifies that "commercial development of oil, natural gas or minerals" includes the exploration, extraction, processing, export, and other significant actions relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity, as determined by the SEC.[11] The following information must be included in the resource extraction issuer's disclosure:

- The type and total amount of payments made for each project;
- The type and total amount of payments made to each government;
- The total amount of payments, by category;
- The currency used to make the payments;
- The financial period in which the payments were made;
- The business segment of the resource extraction 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.

The above disclosure would be filed in interactive data format as an exhibit to the issuer's annual report on Form 10-K, 20-F or 40-F. Also, a brief statement in the annual report directing investors to the exhibit would be required.

IV. Conclusion

The SEC has requested public comment on its proposed rules relating to conflict minerals, mine safety and payments by resource extraction issuers. This comment period expires on January 31, 2011. The proposed rules will not go into effect until the rules are adopted and final. Under the Dodd-Frank Act, the SEC is required to adopt the rules for conflict minerals and resource extraction issuers no later than April 15, 2011. The SEC also expects to adopt the proposed rule for mine safety disclosures in the same time frame.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Elizabeth Loonam at 212.701.3583 or eloonam@cahill.com.

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10 Resource Extraction Release at 11.

11 *Id*. at 13-14.