Conflict Minerals: Is Your Supply Chain Compliant?

Compliance and Ethics

Technology, Privacy, and eCommerce

CHEAT SHEET

- ***Know your minerals.*** In the upcoming reporting year, companies unable to attest to the conflict-free nature of their supply chain will have to report this to the SEC and the public.
- ***Beware the court of public opinion.*** The public is just as concerned about conflict minerals as regulators: Follow the example of industry leaders and inform your customers about your efforts to use conflict-free products.
- ***Where to start?*** Auditing your entire supply chain and determining it free of conflict minerals is no small task; hence you may consider outsourcing to a third party conflict mineral compliance provider.
- ***Proactive compliance beats playing catch-up.*** Stay one step ahead of regulators by instilling a culture of ethical procurement and rigorous data collection.

The Democratic Republic of Congo has some of the most diverse and abundant natural resources found on our planet. Yet it is also one of the poorest countries in the world, ravaged by civil war for over half a century. Armed militias use the country's natural resources to fund their campaigns, and have left an estimated 5.4 million people dead.The mines that provide these resources are often horrible places, employing children as young as seven to perform backbreaking labor under deplorable, life-threatening conditions. In an effort to deprive these armed groups of funding, in 2010, the Dodd-Frank Consumer Protection Act was signed into law by US President Barack Obama. Section 1502 of that act addresses conflict minerals. Conflict minerals are poised to become an even larger factor in supply chain compliance as legislation is currently being proposed in the European Union, which may be more stringent than that currently on the books in the United States.

What are conflict minerals?

In the broadest sense, conflict minerals are minerals that are mined without government oversight and sold to support armed conflict, childhood slavery and any other number of human rights abuses. The Securities and Exchange Commission (SEC) more specifically defines conflict minerals as:

> Columbite-tantalite, also known as coltan (from which tantalum is derived); cassiterite (tin); gold; wolframite (tungsten); or their derivatives; or any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country.

These minerals, abbreviated as "3TG," are used in a wide variety of industries from electronics, to automobiles, to jewelry and food. Companies that fall under the Dodd-Frank legislation must evaluate whether they have conflict minerals in their supply chains, where those minerals are sourced, and report their findings in to the SEC in their public filings.

Who needs to report?

For companies that manufacture (either directly or indirectly) products that contains 3TG minerals, if

those minerals are “necessary to the functionality or production of [the] product” and the company files reports with the SEC under the Exchange Act, then the company falls under the US conflict minerals legislation. But even if you are not a company that falls into this category, if your customers are any of these companies, they will be asking you to trace conflict minerals in your supply chain. According to the General Accountability Office:

> Estimates provided by public commentators responding to the rule indicate that roughly 280,000 suppliers could provide products to roughly 6,000 companies that report to the SEC under the rule and may be asked to provide information on their use of conflict minerals and the origin of the minerals as part of the rule’s due diligence requirements.

The European Union proposed legislation could expand this number exponentially to include anyone importing conflict minerals (whether in raw material form or contained in finished goods or otherwise) into the European Union.

What needs to be reported?

If you are publicly reporting to the SEC, your company will use the Specialized Disclosure Report, known as Form SD to disclose if conflict minerals are in your supply chain and where they originate. Tracing conflict minerals is a challenging task because in some cases it may not be possible to discover the origins of the 3TG minerals in your supply chain. Luckily, the SEC does not require 100 percent certainty but only a “reasonable country of origin inquiry.” Additionally, recycled and scrap materials are specifically exempted as traceability would likely be impossible for such materials. What level of due diligence is required is open to interpretation, but Form SD does specifically require a third party audit of the Disclosure. If a company has examined its supply chain and believes the company is “conflict-free,” the company must disclose how it reached that determination, a description of the products, the facilities used to process the conflict minerals contained in those products, and the efforts to determine the mine or location of origin with the greatest possible specificity and publish this on its website.

Companies were required to file their first specialized disclosure report on May 31, 2014, which covered the 2013 calendar year and then annually on May 31 every year after. For the first two disclosures, companies had the option to state “DRC conflict undeterminable” if they were unable to determine whether or not their supply chain contained conflict minerals. However, in the current reporting year, any companies that are not able to determine whether they are conflict free will have to report that they are not conflict free.* As you can imagine, no CEO would want to attest to this and so companies are putting pressure on their suppliers to comply or be removed from the supply chain.

* This requirement is currently being challenged in US federal court.

Non-public company reporting requirements

If you are not reporting to the SEC, but are reporting to your customer, they will likely be asking you to complete a Conflict Mineral Resource Template (CMRT). This document asked various questions such as: “Do any of the smelters in your supply chain source the 3TG from covered countries?” and “Have you received data/information for each 3TG from all relevant suppliers?” The template also asks whether your company has a publicly available conflict minerals sourcing policy. Prior to completing the template or taking a position on how or what you will provide to your customers, it will

be important to draft a policy and for company leadership to formally adopt it. Other decisions that need to be made are whether you will provide a company-level or a product-level template. Your customers are likely to ask you for the list of smelters and associated 3TG minerals that go into all your products, not just the smelters and 3TGs that go into their products. This is a time consuming effort and will require you to obtain detailed information from your bills of materials so your company will need to determine whether this is a task worth undertaking. If your largest customer asks you to give them a product-specific template, you will likely have no choice but to perform the analysis for them.

Know the lingo

3TG – an abbreviation for the conflict minerals tin, tantalum, tungsten and gold.

DRC – Democratic Republic of Congo, where currently the majority of conflict minerals are mined

EICC – Electronics Industry Citizenship Coalition – industry group that has made efforts to assist industry in tracing conflict minerals in its supply chain

CFSI – Conflict Free Sourcing Initiative – begun by the EICC to assist industry in gathering data about conflict minerals in the supply chain

CMRT – Conflict Minerals Reporting Template – created by the CFSI to facilitate conflict minerals data gathering in the supply chain

Form SD – Special Disclosure Form – form used for disclosing conflict minerals status to the SEC

Smelter – takes ore and melts it down into a purer form – also a pinch point in the mineral supply chain, so compliance has been focused on certifying smelters as conflict free rather than individual mines

What is the status of the current court case?

Shortly after passage of the initial Rules by the SEC in 2012, the National Association of Manufacturers, Chamber of Commerce of the United States of America, and Business Roundtable all sued to stop the implementation of the conflict minerals regulations as violations of the First Amendment. This resulted in a partial stay of the regulations, which allowed companies to forgo the product description portion of the disclosure, but all other portions remained in effect. There has yet to be a final ruling on the case but since there was no guarantee that the Court of Appeals would render its decision before the May 31 reporting deadline, companies have had to prepare their filings as if the rule would be required in its entirety.

Where does the current European conflict minerals legislation stand?

The European Union has proposed regulations requiring conflict mineral importers to self-certify that they have gone through a due diligence process to ensure the minerals they are importing do not

contribute to armed conflict or human rights abuses. The legislation, if enacted as proposed, also enlarges the geographic scope of the due diligence inquiry outside of the Democratic Republic of Congo and Great Lakes region to any “conflict-affected and high-risk areas,” which the Members of the European Parliament would define as “those in a state of armed conflict, with widespread violence, the collapse of civil infrastructure, fragile post-conflict areas and areas of weak or non-existent governance and security, characterised by “widespread and systematic violations of human rights.” These regulations, if implemented as proposed, would be much broader than those in the United States and are expected to impact an estimated 880,000 companies that do business in Europe.

What are companies doing?

The GE Foundation has funded a study on how to reduce conflict minerals in the supply chain. Intel has sent employees to examine smelters in person and now states its microprocessors are 100 percent conflict free. HP has a website dedicated to conflict mineral reduction and reports the percentage of its supply chain that is now conflict free. Apple is working with the Indonesian government and industry groups to create a better system of tracing minerals to their source. So it is clear companies are taking the issue of conflict minerals seriously and actively putting resources and energy into making themselves conflict free.

How do you comply?

Compliance at this stage in the maturity of the supply chain is difficult and potentially costly. Primarily, compliance hinges on gathering data from your supply chain and then either requiring suppliers who are sourcing from uncertified smelters to either remove those smelters’ from their supply base or you will need to remove that supplier from yours. Given that removing suppliers from a supply chain can be cost prohibitive, or even impossible in case of single-sourced components, all other avenues to compliance should be explored before going to business leaders and proposing to remove suppliers.

What are conflict minerals?

Conflict minerals are any minerals whose sale is used to support armed conflict and/or whose production violates human rights. Currently the Securities and Exchange Commission requires publicly traded companies that manufacture, or contract to manufacture, products that have certain minerals necessary to the production of the products, to report in their SEC filings whether those minerals come from the DRC or adjoining countries.

Where to start

To create an effective compliance program, you will first need to know what your universe looks like. To do that, you will need to answer these questions: Do you use tin, tantalum, tungsten or gold in any of your products? If you do, which suppliers supply you with 3TG minerals or 3TG mineral containing products? Does your company already have a data collection method that is well suited to this activity? Is your company publicly traded?

Should you use a third-party provider?

Whether or not to use a third party conflict minerals compliance function provider will depend on many factors, but here are some to consider when determining whether the conflict minerals compliance function should be outsourced.

What in-house resources do you already have? If you already have a team that collects data from suppliers, you may be able to expand upon their current functions to include conflict minerals. Companies operating in or selling into the European marketplace may already be familiar with the Restriction on Hazardous Substances (RoHS) and Registration, Evaluation, Authorization and Restriction of Chemicals (REACH). These regulations involve similar data collection efforts and conflict minerals may be able to piggyback on processes you already have in place for such activities.

How many suppliers do you have? If you have a small supply base, you will likely be able to collect the data, communicate with suppliers, field customers questions, and create your own conflict minerals reporting template (CMRT) on your own. However, if your supply base is large, you will likely not have the internal resources for such a significant undertaking. Each supplier may need multiple emails, calls, and even training in their language before they will be able to create a report for you. And customers will need their emails and calls responded to as well.

What kind of supply base do you have? If your suppliers are large, publicly-traded companies, they will likely already have a template prepared and be actively working on removing non-certified smelters. However, if your suppliers tend to be smaller, mom and pop type operations, especially outside the United States, they will need some assistance in understanding the regulations and what is needed.

Even if you choose to outsource, you will still need individuals who are dedicated to responding to the third party's request for information and for pushing on the suppliers if responses are not forthcoming or are less than adequate. In some cases, it may make sense to outsource the function in the first year or two while learning and ultimately bringing the process in-house.

Selecting a third party conflict minerals compliance provider

Companies that will serve as your outsourced conflict minerals solution come in a wide variety of flavors. Some act as consultants and then acquire the software and manpower from outside sources. Some focus more on the data warehousing aspect. Others emphasize due diligence and data analysis. What in-house resources you have will determine which solution will be most appealing. If you do not have in-house data gathering capabilities, given the labor intensiveness of this effort, you would be wise to select an outside provider who can do this at low cost. In other words, third party providers with employees located in low-cost countries will be able to do the leg-work required with the least expense.

Another aspect to consider is how many times the provider will solicit information from your suppliers before they turn that task back to you. If suppliers are unresponsive, you will likely end up doing much of the work yourself. Some suppliers may refuse to provide information to someone other than their customer, so it may make sense to allow the third party provider to use company email to send out information requests to your suppliers.

When the provider receives data back from your suppliers it is equally important that the provider

perform due diligence on those responses. While the CMRT contains some mechanisms to ensure the supplier is entering correct information (i.e., real smelter names rather than holding companies or aliases), nevertheless, many of the templates you receive back will require corrections. The third party provider should be responsible for not only obtaining templates, but also ensuring that those templates are correctly completed.

As you can imagine, many suppliers are still in the learning phase and will need assistance completing their CMRTs, so a third party provider that provides training, in multiple languages, and has a help desk or email ticket system, is important.

Remember, no matter who you choose to perform this function for you, your company is ultimately the one responsible for the reported results. Outsourcing does not remove the obligation to fully understand your company's needs and legal requirements and advise your client appropriately.

Conflict minerals in the European Union

Like the United States, the European Union is also attempting to address conflict minerals in the supply chains of companies that choose to do business in Europe. However, unlike the US regulations, the European Union proposed regulations appear to be trending toward much broader enforcement, aimed at importers rather than only publicly reporting companies. Additionally, the EU proposed regulations do not only focus on the Democratic Republic of Congo, as the United States does, but aim to eradicate conflict mineral sourcing that supports armed conflict in any high risk area of the world.

Status of the current court case

Filed in 2012, the case attempting to halt the implementation of the SEC rules has yet to be finally adjudicated. As such, companies are well advised to proceed as if the SEC rules will remain in effect for the foreseeable future.

What if your suppliers won't respond or won't comply?

Unless you have a very small group of 3TG suppliers, you likely will have many that do not respond to requests for CMRTs. Additionally, many CMRTs that you do receive will have non-certified smelters listed. Certainly conflict minerals compliance, and even the provision of a CMRT, should be gating items to setting up new suppliers, but what do you do with suppliers that already exist in your supply chain? Removing them may not be an option as they may already be designed into your product or there may be no alternate source. You will need to have a conversation with your business leaders to understand what they want to do with non-compliant or nonresponsive suppliers. Suppliers should be informed that not complying will have a direct impact on the business relationship with your company, either through decreased share or cessation of business altogether. Additionally, continuing to put pressure on your suppliers to remove non-certified smelters will show how important this effort is to your organization. This message should come from a C-suite executive such as the

chief procurement officer and should be delivered to the supplier by the commodity manager who purchases materials from that supplier.

Whose job is this?

If your company is in the beginning stages of implementing a conflict minerals compliance program, the legal department will likely be the one tasked with deciphering the legislation and advising business on what needs to be done. However, once you begin digging, it will become obvious that legal can really only act in an advisory function and the actual data gathering will need to be done by whichever group is both closest to the supply base and able to provide the most pressure should supplier responses not be forthcoming.

In many companies this is the sourcing group or procurement. Legal will often draft or review supplier communications; however, these should be signed and sent from the procurement or buying groups as this will give these communications more weight and incentivize suppliers to comply in either removing noncertified conflict-free smelters from their supply chain or certifying that all such smelters have already been removed.

What the future holds

Given the incredible success that the Dodd-Frank conflict minerals legislation has had in steering industry in a certain direction, and the expanding regulations in the European Union, there are bound to be follow-on initiatives aimed at eradicating other human rights abuses in the world. So, the process you set up now to obtain as much information as possible from your suppliers, create a database to house that information in an easily-searchable format, and institute a system by which to communicate requirements regularly with your suppliers, the better shape you will be in when other initiatives make it into law.

Sasha Glassman

Assistant General Counsel

Rogers Corporation

Her responsibilities at global materials manufacturing company Rogers Corporation include leading the company’s Business Integrity Program. Glassman also created and teaches the foundational Corporate Compliance and Ethics Program at Arizona State University’s Sandra Day O’Connor College of Law.