United Nations Economic Commission for Europe
Expert Group on Resource Classification
Fifth Session, Geneva 29 April – 2 May 2014

Social Policy Initiatives through Public Company Disclosures

Kathryn A. Campbell

Sullivan & Cromwell LLP

April 30, 2014

Dodd-Frank – Social policy through disclosure requirements

- US Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted in 2010 to implement reforms in the banking industry and financial services sector but also enacted requirements for new public company disclosures relating to certain social policy issues
- Congress directed the US securities market regulator, the SEC, to issue rules requiring SEC registered public companies, both US and non-US
  - to disclose payments to governments relating to natural resource extraction activities
  - to disclose whether their products use minerals that originated in the Democratic Republic of Congo ("DRC") or its adjoining countries

Payments to Governments

- Payments to Governments
  - Congress intended for the payments disclosure rule to increase the accountability of governments to their citizens in resource-rich countries for wealth generated by those resources
  - The purpose was to achieve a social benefit which differs from the SEC's usual role of investor protection.
  - The SEC's payments rule was adopted in 2012. Although based on EITI concepts, it contained specific disclosure requirements to be contained in a new public filing by individual companies. The rule was challenged by the API and various other industry groups in the US district court and in July 2013 was vacated

Payments to Governments

Continued

- The court identified two "substantial errors": (i) it said the rule's requirement for companies to disclose publicly their respective payments to governments was not justified by the rationale given by the SEC and (ii) the SEC acted arbitrarily and capriciously under the Administrative Procedures Act in denying any exemption where disclosure of payments information is prohibited by the law of the host country
- The rule had also been challenged on constitutional grounds, but the court did not address this issue
- Companies are awaiting a new SEC rule proposal
- In the meantime, EITI has accepted the United States as a "candidate" country making the US the first G8 country to begin implementing EITI's requirements

Conflict Minerals

- Conflict Minerals
  - The Dodd-Frank Act also directed the SEC to implement regulations requiring companies using "conflict minerals" to investigate and disclose the source of those minerals whose exploitation and trade Congress believed are helping to finance conflicts characterized by extreme levels of violence, particularly sexual and gender based violence, contributing to an emergency situation in the eastern DRC
  - This new requirement was principally targeted at the high-tech industry although it has broad reaching effect
  - After a long and extended comment period the final SEC rules were adopted on August 22, 2012 and the due date for first new disclosure report is fast approaching - May 31 (June 2), 2014

Conflict Minerals

Continued

- This rule has also been challenged in the courts
  - Shortly after the SEC adopted the final conflict minerals disclosure rules in August 2012, a coalition of business interests filed a legal challenge to these rules
  - Although the rules were upheld by the U.S. District Court in July 2013, the decision was appealed to the Court of Appeals
  - Earlier this month the Court of Appeals held that the rule's requirement to state that products "have not been found to be DRC conflict free" violated the U.S. Constitution's First Amendment protection against compelled speech by requiring an issuer to accept moral responsibility in a way it disagrees with
  - The court stated, "By compelling an issuer to confess blood on its hands, the statute interferes with that exercise of the freedom of speech under the First Amendment"

Conflict Minerals

Continued

- Notably the court did not stay or vacate the enforcement of the SEC's rules
- The Commission is divided with two Commissioners publicly stating their view that the rule should be declared invalid and that the approach behind the statute should be reconsidered
- However, the SEC announced on April 29th that the rule remained in effect and the reports are still due by the due date
- SEC stated that issuers are not required to state whether or not their products are "DRC conflict free". Although you can if you want, provided your due diligence is audited
- SEC will issue more guidance

Three Step Approach

- The SEC's Rule outlines a three step process:

  Step one:

  - Determine if "conflict minerals" are necessary to the functionality or production of the products that it manufactured or contracted to be manufactured
    - Manufacture does not include mining/extraction of minerals but it does include refining
  - "Conflict minerals" currently include tin, tungsten and tantalum and gold ("3TG") which are used in a wide array of products - mobile phones, computers, video games, digital cameras and other consumer electronics as well as vehicles and jewellery
  - There is no de minimis threshold in the rule – SEC said that would be contrary to the congressional intent
  - Most companies will have conducted Step One by now and have determined whether they have products that are in scope
  - Oil and gas companies have been investigating the use of catalysts in the refining process - The SEC has stated that catalysts are in the scope if that conflict mineral otherwise is necessary to the production of the product and is contained in any amount, including trace amounts, in the product

Three Step Approach

Continued

Step two:

- If any such products are identified, the company is required to conduct a "reasonable country of origin inquiry" ("RCOI") and disclose in a report to the SEC whether their conflict minerals were sourced from the DRC, adjoining areas or unknown areas and proceed to Step Three (unless the minerals did not originate in a covered country or are from scrap or recycled materials)
- There is no prescribed method for conducting an RCOI. The SEC indicated that an RCOI will be satisfied if the issuer seeks and obtains reasonable reliable representations indicating the facility at which its conflict minerals were processed
- It may not be necessary to hear from every supplier provided there are no "red flags"

Three Step Approach

Continued

Step three:

- Exercise due diligence on the source and chain of custody of its conflict minerals pursuant to a nationally or internationally recognized due diligence framework – e.g. the OECD Due Diligence framework
- File a conflicts minerals report that describes the due diligence efforts and whether those products contain conflict minerals sourced from a covered country
- Not required to state that they are DRC conflict free but if you do an audit report on the due diligence is required
- Temporary transition period if results of this due diligence are incomplete

Policy Issues

- Notwithstanding the uncertainty surrounding the new disclosure requirements, many of the large electronics firms are engaged in their own private efforts to clean up their supply chains
- Intel made headlines when it announced that it was "conflict free" as of January 1, 2014 after extensive efforts to verify its microprocessor supply chain working with partners in the Conflict-Free Smelter Program
- Although serious questions remain about the appropriateness of using the SEC's public disclosure requirements as the route to highlight social policy issues, it appears to be an area of growing interest for investors and regulators

Sullivan & Cromwell LLP