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Law360, New York (August 23, 2012, 1:47 PM ET)—The Conflict Minerals Rules mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act have ranked among the most controversial Dodd-Frank provisions – Aug. 22's U.S. Securities and Exchange Commission http://www.law360.com/agencies/securities-and-exchange-commission open session announcement of the final rules helps explain why.

Whatever one's position on the public policy wisdom of the announced final rules, it is now clear that auditing complex supply chains and vetting difficult-to-control vendors, often located worlds away, has become the new corporate imperative.

In the morning hours of Aug. 22, the commission held its highly anticipated public meeting to announce its final Conflict Minerals Rules pursuant to Dodd-Frank Section 1502.

Generally speaking, these rules mandate that publicly traded retail and manufacturing companies evaluate the minerals used in their products and provide public disclosures regarding their investigation and findings through the newly-minted "Form SD."

Where "conflict minerals" - including tin, tantalum, tungsten and gold - are found in the supply chain, the compliance and disclosure burdens will be substantial. According to the commission's press release:

"A company that uses any of the designated minerals is required to conduct a reasonable 'country of origin' inquiry that must be performed in good faith and be reasonably designed to determine whether any of its minerals originated in [the Democratic Republic of Congo or neighboring countries ('covered countries')] or are from scrap or recycled sources."

More specifically, where a company's country of origin inquiry reveals that (1) the conflict minerals in its supply chain may have originated in the "covered countries" and (2) the minerals may not be from scrap or recycled sources, those companies must conduct "due diligence" on the sources of those materials, including engaging an independent third-party auditor.

During the meeting, each commissioner commented on the complicated issues posed by Dodd-Frank Section 1502 and the long, intricate and contentious rulemaking process involved.

There is also consensus, within the commission and beyond, that the human rights abuses and other problems Section 1502 is intended to address are serious and warrant action.

Beyond that, however, the commission split sharply, voting 3-2 to adopt rules that sweep broadly and which, by the commission's own estimate, include aggregate initial compliance costs of $3-4 billion and annual compliance costs of $209-$609 million.

The dissenting commissioners noted that, although the commission could have exercised its discretion to narrowly draft the rules mandated by Dodd-Frank, the commission instead chose an expansive approach. By way of example, the commission declined to include a de minimis exemption or an exception for certain classes of issuers, as many commentators had proposed.

The commission also declined to define key terms in Section 1502. For example, although the rules apply only to companies that "manufacture" or "contract to manufacture" products for which conflict minerals are "necessary," the rules define none of those terms. Instead, those terms are to be applied based on the "facts and circumstances" of each company and product.

Finally, although the rules technically only apply to publicly traded companies, their impact certainly extends to private companies supplying public companies with products potentially containing conflict minerals.

Pursuant to the rules, such private companies must be prepared to participate in public company's now-mandated due diligence and vetting efforts.

The commission will publish its final rules in the coming days. But today's meeting makes clear that affected companies should expect:

To Make a Significant Investment in Compliance

The commission's final estimate of initial compliance costs was $3-$4 billion - over 5,000 percent more than its initial estimate of $71 million. (As the commission put it, the rules' benefits are "to society as a whole" and "difficult to quantify and qualitative in nature")

Few Blanket Exemptions

The commission chose not to exercise its authority to carve out either a de minimis exemption for conflict mineral content or an exception for certain classes of issuers.

Little Guidance

The commission has chosen to leave undefined critical terms such as “necessary,” “manufacture” or “any influence over manufacturing.” This means companies will need to carefully monitor the commission’s promised guidance, enforcement actions and ongoing interpretation of these rules to understand their meaning.

In addition, the commission has provided no guidance for how a company should respond when its supplier or subcontractor (or sub-supplier or sub-subcontractor) provides incomplete or belated information, or altogether refuses to provide information, about the products and materials it supplies.

To Make Additional Public Filings

The commission has introduced “Form SD,” which presumably stands for “specialized disclosures,” through which conflict minerals disclosures must be made, either as part of an annual report or as an appendix thereto.

It appears from today’s meeting that even companies that determine they do not use minerals from covered countries must still submit Form SD, briefly describing the inquiry they made leading them to that determination.

The frequently suggested option of complying by simply filing a disclosure on the company’s homepage is, in short, off the table.

To Engage Independent Third-Party Auditors

Any company that must, under the rules, engage in “due diligence” on the minerals it uses will be required to have its report or diligence audited by an independent third party, applying standards that the commission acknowledges are, in many cases, “evolving.”

To Adapt to the New Rules Quickly

The commission has included a modest phase-in period of two years for larger companies, and four years for smaller companies, within which they may classify certain products as unable to determine the origin of conflict minerals.

That said, the new Rules will cover the calendar year and become effective for conduct occurring in 2013. The 2013 Form SD must be filed before May 31, 2014.

What Now?

Create conflict minerals risk profile based on:

- Preliminary lists of products potentially containing conflict minerals;
- Key supplier documents and agreements;
- Targeted interviews of personnel with supply chain oversight; and
- Prioritized lists of potential problem areas and ways to address them.

Design and implement a practical supply chain compliance program, including a:

- Conflict minerals code of conduct setting forth expectations for employees and transaction partners (including suppliers);
- Compliance questionnaire for suppliers;
- Supplier compliance database;
- Risk management plan; and
- Customized “country of origin” inquiry program.

Train relevant employees regarding:

- Conflicts minerals rules and resources;
- Best practices for supply chain investigation and oversight; and
- Cross-training for key suppliers with greatest risk exposure.

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