Comments to the SEC

Following on from the SEC round table discussion on the conflict minerals provisions of S 1502, I would like to add a few remarks to the record.

1. On the allegation that there is an embargo on minerals from the DRC

Some use was made of the word "embargo," especially by the ITRI delegate. No such embargo exists, nor is an embargo contemplated by the multi-stakeholder group, the EICC/GeSI initiative, or ITRI. Import statistics show that minerals continue to be sourced in substantial volumes from the DRC, for example tantalum ores going into China.

It is true that a UK based company, AMC, recently halted all its procurement efforts for tin ores from the DRC. These ores had been purchased for smelting in Thailand at the company's Thaisarco smelter, and when AMC was linked by press and NGO reports to conflict-derived tin, the company then halted its activities. AMC may be a member of ITRI and this could explain the remarks by the ITRI delegate, but the SEC should keep firmly in mind that there is not, and there are no industry plans for, an embargo on the region's minerals.

To the contrary, there are efforts by private industry to increase supply from the region and provide issuers with certainty as to the conflict-free nature of the 3TG minerals thus supplied. These efforts include for instance the Motorola-AVX "closed pipe" project, and also ITRI's bag-and-tag scheme.

2. De minimis principles

Both panels debated the idea of a de minimis standard, with the speaker representing TE Connectors advancing arguments in favour of de minimis principles on a per-product basis.

To accept such a principle would be to destroy the intent of the law. For example, a computer logic chip contains perhaps a few milligrams of tantalum. On the other hand, the semiconductor industry as a whole consumes over 100 tons of tantalum metal annually with consumption concentrated into a small number of major manufacturers, with Intel alone accounting for close to 50% of this volume. Applying the TE proposal would, by extension, exempt (for example) all computer logic chips. Many of TE's products have similar characteristics, namely small amounts of 3TG minerals per product but a significant volume of material on a company-wide basis.

It is worth noting that members of the multi-stakeholder group rejected explicitly at the round table the concept of de minimis, including members of industry as well as the NGO community.

The SEC should reject and not consider further the TE de minimis proposal nor any other de minimis concept.

3. Essential for use

There were many comments advanced on this question. It may help to think about the problem from the other direction, namely thinking first about what is ruled in.

We are talking about manufactured products. These are designed, engineered things where people with expertise have made deliberate choices about how the products look, what functionality and performance they should have, what they need to cost to make, suppliers identified, qualified, and contracted, and so on. Clearly, where a choice has been made to incorporate into the product one of the 3TG minerals, it is because the designer has deemed it necessary to include that mineral. It cannot be the case that such design choices are accidental. Such products therefore fall within the scope of the law.

Similarly, many products require the consumption of 3TG minerals in their manufacture. An example would be tungsten cutting tools used in metal machining. Where products require 3TG consumables in their manufacture, they also fall within the scope of the law.

There was discussion about contract manufacturing. The term itself provides very useful guidance: a contract manufacturer is one with whom a company has contracted in order to have a product manufactured. While it is theoretically possible that a contract manufacturer could be asked simply to supply, say, a television, this in practice is an absurd suggestion. For the television in this hypothetical example to be merchantable and fit for sale, it must be defined at the absolute least as to dimensions, performance and cost, appearance and brand name, digital or analogue, and must meet product safety and electrical performance standards that change with country of sale. So, the contract requires the purchaser actively to participate in the specification and design of the product.

Purchasers of such products can thus readily include in their supply discussions requirements on any matters of compliance (this is already the case for electrical appliances, for which there are regulations on electromagnetic interference in many countries including the US), and therefore should not be permitted to evade the law by this argument.

A practical approach may be to require that any company materially involved in the specification and/or design of contract manufactured products should be required to report under the law. A materiality threshold must be defined and in the unlikely event there is no adequate established precedent, I suggest that specifying one or more aspects of the product to include, but not limited to, cost/price, dimensions, appearance, or relevant product safety and grid conformance standards, all should count as material to the manufacturing of the product under contract.

4. Single reporting date

I agree with the proposals from many parties for a single date for reports. I do not think it matters if the date is decoupled from the annual report. A single date will minimise the burden on the supply chain.

5. Timing of implementation

There were two thrusts to this point that stood out: either a phased-in approach with some industry panelists arguing for several years of delay, or a prompt start date with some flexibility for companies in how they define the 3TG content of their products for a period of time.

The latter approach makes much more sense. A delay clearly flouts the intent of the law, whereas implementation now but including some reporting flexibility starts the process and, while reporting will not be perfect initially, permits companies to focus on complying with the law rather than stalling.

Moreover, all companies are able today to say what they have done to comply with the law. The facts may be embarrassing for some filers, but the law was not intended to spare blushes. As I noted in my prepared remarks, ignorance cannot be used as a shield where the law is concerned.

I am sympathetic to the concern expressed that perfection is too much to ask. As the popular political adage goes, perfection is the enemy of the good. This was explicitly recognised by the NGO members of the panel as well as by the sponsors of the bill in the Congress.

Delays create uncertainty and uncertainty is not positive for business decision making and investment. The DRC mineral industry is not helped by uncertainty, and a clear set of rules here will, by removing uncertainty, provide an opportunity for investors to return to the DRC once again.

Finally, many of the comments made at the round table were addressed, in my view, to exceptions and frequently to what will, in the real world of commerce, be very rare exceptions. While a cynic may see companies as simply trying to subvert the law, we should recognise that perfection immediately is a standard that forces companies to the world of minute probabilities since, given the costs of non-compliance, companies would face large costs if these small-probability events occurred.

6. Audit scope

For smelters, the EICC/GeSI process is an intrusive audit examining details such as purchase orders and invoices, inventories, and supplier contracts. While the

process itself could be improved, I believe it to be a robust process adequate to establish at the smelter level whether or not 3TG minerals are conflict sourced.

Firms other than smelters covered by the law should therefore not be required to audit past the smelters provided the smelters in question have been included within the EICC/GeSI initiative, or an at least equally robust audit process. This will lessen the burden and cost of compliance.

7. Furnish versus file

It is natural for companies to resist more stringent filing requirements and advance a preference for less stringent requirements. In my opinion, the bias towards furnish should increase as rules move in the direction of auditing actual conflict mineral usage in an issuer's products. However, if the audit is instead focused on a company's internal processes and procedures, things entirely within the control of management, then I believe a requirement to file is appropriate. Management competence is a key factor in investors' valuations of companies and there is no justification for adopting a lax rule where managers are directly in control of circumstances.

8. Supply chain complexity

Although some panel participants were quick to produce very large numbers for their suppliers, the audit problem in fact is much more tractable, and the SEC should be sceptical of suggestions of a cast of thousands.

At the OEM level, firms are purchasing mostly subassemblies and components. These are discrete items and many (typically a substantial majority) of them will have no 3TG content. Those that do contain 3TG minerals are to a very high percentage readily identifiable. I refer back to my comments in point 5 and note that while 100% identification of 3TG minerals may not be possible immediately, I would expect that once manufacturers resolve to tackle the issues, instead of attempting to postpone dealing with them, they will quickly see that they can identify the vast majority of their 3TG exposure.

9. Supply contracts

We heard that OEMs are unable to exert influence on their supply chains and may not, quickly, be able to amend contracts to require compliance with the law on 3TG sourcing.

There may be examples of companies in the supply chain where an OEM lacks powers of persuasion, but they are likely to be the exception rather than the rule. Most investors would be shocked at the suggestion companies they have invested in cannot quickly adapt their suppliers' practices in this regard, and in truth the claim, as a general principle, strains credulity.

Most suppliers, recognising that their customers need the information and that they are not being asked to disclose commercially sensitive data (which they are not) will be happy to help. A recalcitrant few may exist but since there is no value in saying no, and since firms generally act rationally, the objections will be rare indeed.

Suppliers may change from time to time, and their share of a customer's business can rise and fall with commercial forces. However, suppliers are almost always subject to a qualification process (even service providers such as paper retailers and telecoms providers are frequently subject to procurement negotiations). So, including compliance with conflict minerals rules as part of the supplier qualification represents only an additional step in an existing process.

Referring again to my point 5 above, I believe there is a legitimate concern here around statistical outliers in a company's supplier network, but that as a general rule the arguments of a lack of influence over suppliers do not hold water.

10. Costs and network benefits

Many of the tier 1 and 2 suppliers of a given OEM will supply multiple OEMs. The overlap of suppliers and customers in fact extends to all levels of the supply chains of the 3TG minerals.

The commonality of customers and suppliers dramatically reduces the cost and effort involved in compliance for 3TG supply chains. Once a supplier has mapped its upstream suppliers of 3TG material inputs for one customer, the work has been done for all customers. Since, as we heard from a number of speakers at the round table, firms typically have multiple suppliers, we can expect these network benefits to be the rule rather than the exception.

So, the fact that Apple has mapped its 3TG supply chains back to the smelters means that a wide range of electronics companies can enjoy a free ride for at least some of their obligations under the law, thanks to Apple.

11. Standardisation

Further simplification comes from common approaches. As noted at the round table, the EICC/GeSI initiative includes a standardised reporting tool that can be used by all firms, regardless of membership in the EICC or GeSI, to map their supply chains back to 3TG smelters.

Industry groups such as the NAM and the US Chamber of Commerce can also play a valuable and constructive role here. Developing and communicating standard language for contracts and purchase orders would facilitate compliance, and would further reduce the already modest true (cash) costs of these administrative changes.

12. Management information systems

In many industries it is common practice to audit one's suppliers. I have first hand experience of this from the electronics industry for instance. In industries where quality is given a high priority and where root-cause identification of product defects is the norm (electronics for example, but clearly also automotive, medical technologies, and aerospace) a great many suppliers are already being routinely audited by customers, amongst other things for their quality systems.

Quality systems are designed to trace product problems back to their root causes. Thus components of a product are tracked at each level of the supply chain, back to their constituent elements. While these systems are not universal they are ubiquitous in many industries and very much the rule.

Even where detailed quality systems are absent, inventory management and cost accounting systems provide traceability between input materials and output products.

The work comes in integrating the information from one stage of the supply chain to the next. This is where tools such as the EICC/GeSI mapping tool come in. Although it is not trivial to use the tool, it will be a very rare company that has to implement major changes to its ERP systems to comply with the law. As previously noted, Apple has already mapped its supply chain and is a user of all four of the 3TG minerals. This is partly a reflection on Apple, and partly a reflection of the quality systems of the electronics industry, but it is also in part an illustration of the ability quickly and efficiently to meet the requirements of the law when a company is motivated primarily by compliance rather than obfuscation.

Opening Statement
Andrew Matheson

I think it is helpful in contemplating the implementation of S1502, to recall first the history of the issue as it pertains to businesses, and then to draw some broad conclusions from the history that are relevant to the process of developing and issuing regulations on conflict minerals by the SEC.

Industry first became widely aware of the link between the mineral trade and the conflict in the eastern DRC, in the wake of the 2001 UN Security Council report. In the ten years since the UN report was published, efforts have been made by private industry to halt the purchase of conflict-derived minerals. The initial impetus began in 2001 and came mainly from public companies in the US and the EU, with a clear instruction to their suppliers to address shortcomings in procurement practices and help satisfy consumers' demands for ethically sourced products.

Bipartisan US legislation was first seriously mooted three years ago, notably (though not solely) by Senators Brownback and Durbin, and provides the substance of the provisions we are here to discuss that were enacted in the 2010 finance bill.

The EICC/GeSI smelter audits that began in earnest in the past two years, and initiatives such as ITRI's bag and tag scheme, are today creating a reliable end point for supply chain audits by addressing the mining and processing industries.

We can draw several conclusions from the history:

1. This issue matters to corporations including those regulated by the SEC. Corporations acted, and committed resources, long before government acted, and continue to press the issue and commit resources to this day.

Corporations are not altruistic entities. They act because it is in their interests, and therefore the interests of their shareholders, to do so. The presence of conflict minerals in their products is manifestly a material concern and whatever the costs of compliance, we can infer that the value of compliance must be greater.

2. There has been ample time for firms to prepare systems to manage conflict minerals out of their products. Even companies that oppose the current legislation cannot prudently have ignored it, and have had three years to prepare contingency plans. Ignorance of the law is never an adequate defence and lack of preparedness ought to indicate to investors that there are weaknesses in the management of laggard companies affected by the law.

3. Many firms have begun, and some have completed, supply chain mapping back to the smelters. Since suppliers of components frequently sell to many customers across diverse markets, the early movers create large network benefits and drive cost and complexity out of the audit process for followers. Costs will be

dramatically lower, and implementation times much shorter, because of these network effects.

4. This is not just a US issue. Leading firms from around the world are part of the EICC/GeSI project and many foreign companies are regulated by the SEC via their ADRs. Moreover, global procurement means there will be no singling out of US companies under this rule.

5. Self certification does not work, as import statistics demonstrate. Companies are not required under the law to stop using conflict minerals, but they are required to disclose their practices. Verifiable disclosure allows those companies whose customers care about the issue, to market ethical products. This protects the value of these companies and hence protects their shareholders.