Consumer Electronics Retailers Coalition

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U.S. Securities and Exchange Commission
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Release No. 34-63547; File No. S7-40-10
RIN 3235-AK84
Conflict Minerals
Proposed Rule

FURTHER COMMENTS OF THE

CONSUMER ELECTRONICS RETAILERS COALITION

November 1, 2011

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Electronically Submitted

November 1, 2011

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Securities and Exchange Commission
100F Street, NE
Washington, D.C.20549-1090

Re: File No. S7-40-10, Release No. 34-63547, RIN 3235-AK84 Conflict Minerals Proposed Rule.

FURTHER COMMENTS OF THE
CONSUMER ELECTRONICS RETAILERS COALITION

The Consumer Electronics Retailers Coalition ("CERC") submits these Comments in response to the SEC's Notice inviting further comment[1] on its Proposed Rule[2] in light of industry experience and the Commission's October 18 Roundtable discussion. CERC commends the SEC for seeking additional comment in recognition of the difficult and complex issues raised by Section 1502 and the Proposed Rule. These CERC comments supplement the joint comments filed by CERC and the Retail Industry Leaders Association (RILA) on March 2. CERC endorses the supplemental comments filed on this date by RILA, and files these CERC comments based on experiences and circumstances particular to the consumer electronics industry.

Since the Proposed Rule was published and the initial round of comments filed, the reports of atrocities in the DRC, and the need for some action by the international community, unfortunately have not abated. Moreover, from all reports it appears that since the publication

[1] The SEC notices as to the Roundtable and the re-opening of the record, and the Roundtable transcript, are found at http://www.sec.gov/news/otherwebcasts/2011/conflictmineralsroundtable101811.shtml.
[2] SEC, Conflict Minerals, Release No. 34-63547, File No. S7-40-10, 75 Fed. Reg. 80948 (Dec. 23, 2010) ("Notice").

date, the majority of the beneficial commerce in minerals has continued to leave the region. CERC and its members join the SEC in seeking, and are committed to the establishment of, an institutional regime to assure that manufacturers will be able to procure products with confidence that they are not contributing to conflict and atrocity in the DRC. As is illustrated by the Roundtable discussion, however, this must be a matter of years rather than months.

CERC believes that the only reasonable interpretation of Section 1502 is that, to the extent retailers are not themselves manufacturers, their participation in this international effort is voluntary. The plain language of Section 1502 imposes a reporting duty only on "manufacturers." This limitation is not in any way expanded by the "contracted to be manufactured" language that appears elsewhere in Section 1502. As CERC and RILA discussed on March 2 and as CERC elaborates below, consumer electronics retailers, standing at the end of long and webbed supply chains, lack insight or managerial oversight as to materials sourcing or processing. Thus, the plain reading of the statute – assigning disclosure obligations only to persons who *are* manufacturers – is also the most reasonable one.

CERC's firm legal position that the SEC's regulation cannot exceed the authority delegated by the Congress in Section 1502 does not lessen its members' commitment to working with all stakeholders to achieve the purposes of the law. CERC members are committed, consonant with their position in the supply chain and their ability to influence their manufacturer vendors, to achieving the results sought by the Congress and the SEC.

I. A RETAILER IS NOT A PERSON DESCRIBED IN SECTION 1502(p)(2) UNLESS A PRODUCT CONTAINING OR PROCESSED WITH A CONFLICT MINERAL IS "MANUFACTURED BY" THAT RETAILER. HENCE A RETAILER THAT DOES NOT OWN OR MANAGE A FACTORY IS NOT AMONG THE ISSUERS COVERED BY SECTION 1502.

The obligations imposed by Section 1502(p) apply *only* to "any person described in paragraph (2)." Paragraph (p)(2)(B) is clear and unambiguous that these obligations attach only to "a product manufactured by such person," and to no-one else. The paragraph (p)(1)(A)(ii) language addressing reporting obligations by entities *already covered as issuers by paragraph (p)(2)(B),* referring to products "manufactured or contracted to be manufactured," does not and cannot reasonably be read to expand the provision which clearly defines who is a "person" covered by Section 1502. To read this language as imposing obligations on any issuer who is not a "person described" would be an unwarranted expansion of the power delegated to the Commission by Section 1502, hence would be unlawful.

This plain reading of the statute provides also for its most consistent interpretation and administration. As the CERC-RILA March 2 filing spells out, par. (p)(1)(A)(ii) is most plainly read as imposing reporting requirements only on those who have been defined as persons covered by Section 1502. Thus, par. (p)(1)(A)(ii) governs contracts between and among manufacturing entities.[3] Accordingly, it would be beyond the SEC's authority to impose a

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[3] CERC respectfully notes that nothing in the SEC's history or expertise would reflect an expectation that the SEC could make an "expert" reading of Section 1502 based on any SEC experience or precedent with respect to contracts pertaining to manufacturers, retailers, or conflict minerals. Compare, *Chevron U.S.A, Inc. v. NRDC*, 467 U.S. 837, 866 (1984). Nor, even if expert, can an agency make a policy judgment at odds with a plain reading of the statute. *Id.* at 843. Nor should an agency be able to rely on *Chevron* expertise to confer jurisdiction on itself. *See* Nathan Alexander Sales and Jonathan H. Adler, "The Rest is Silence: 'Chevron' Deference, Agency Jurisdiction, and Statutory Silences," University of Illinois Law Rev. Vol. 2009 No. 5, 1497-1565, George Mason Law & Economics Res. Paper No. 08-46, Case Legal Studies Res. Paper No. 8-20, reviewed at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1213149.

reporting obligation on retailers who are not manufacturing entities. In so doing, the SEC would be imposing not just a new *reporting* requirement, but a new *business obligation disguised as a reporting obligation*. This business obligation would be orthogonal rather than related to what retailers do in their ordinary course of business. It is simply beyond the power of the SEC to impose any such obligation in the absence of a delegation by the Congress of the power to do so.[4]

II. IN THE EVENT THAT FINAL SEC REGULATIONS IMPOSE OBLIGATIONS ON PERSONS WHO ARE NOT MANUFACTURERS, CERC SUPPORTS THE INTERPRETATION OF "CONTRACTED TO BE MANUFACTURED" AS PROPOSED BY RILA.

In the event that the final and implemented SEC regulations do apply to issuers who do not manufacture, CERC agrees with RILA's comments of this date that such a rule could reasonably apply only where:

(i) the issuer has a direct contractual relationship with the manufacturer of the product to be sold by the issuer,

(ii) the issuer has substantial control over the manufacturer and the material specifications of the product, and specifies the conflict mineral(s) to be used in the product,

(iii) the product will be manufactured exclusively for the issuer, and

(iv) the product will be sold by the issuer under its own brand name or a brand name owned by the issuer or exclusively licensed to the issuer by the owner of the brand.

This formulation is grounded in the actual dealings between retailers and manufacturers, especially with respect to consumer electronics products. Even where a retailer provides specifications for a manufactured product, it is uncommon in the electronics sector for any contract or any other communication to the manufacturer to address the inclusion of minerals, or

[4] Please see the March 2 CERC-RILA comments for a discussion of the legislative history that narrowed the scope of Section 1502 to issuers who are "manufacturers."

their use in the course of manufacture. Thus there is no rationale in existing business practices to assume that "contracted for" would pertain to conflict minerals in the context of a design and procurement contract for private label goods. Nor is there any basis in the SEC's record for any such assumption. Hence, even if applied to issuers who only "contract for" exclusive or private label products, Section 1502 should not apply to a contracted product unless the contract specifies the use of conflict minerals in the product or in its manufacture.

A. Consumer Electronics Retailers Lack Insight Into Incorporation of Minerals Or Their Use In Processing.

Because contracts by retailers for the manufacture of consumer electronics products rarely if ever specify minerals to be used in products or processing, consumer electronics retailers lack the experience, insight, or ability to govern or evaluate their sourcing, or even to verify that the information supplied to them by their vendor manufacturer is correct. It is the manufacturer alone that determines the production methods and materials that are best suited to filling a retailer's product order – even in those instances in which the retailer has furnished all requirements as to design, quality, and performance.

Consumer electronics retailers do test products received from vendors in their final configuration, as to compliance with FCC Part 15 radio emissions regulations, and as to whether they contain dangerous substances or would be potentially harmful to children. These issues of fact can be established through analysis of finished goods by independent laboratories. Consumer electronics retailers also endeavor to assure that their direct manufacturer vendors are in compliance with the expectations of U.S. law and policy with respect to product safety and working conditions. CERC members take such legal obligations and policy expectations seriously, and they retain experts to inspect products and factories in these respects. However, these inspections, and retailers' competence to evaluate, store, and manage the information they

produce, do not extend beyond matters that can be observed by expert evaluation of (a) the final, finished goods, and (b) the vending manufacturer's own factory floor. They do not extend to any inspection of components or their sourcing, and they do not extend to the production facilities for any of the myriad components and materials that it is the manufacturer's task and responsibility to acquire, or to the provenance of the materials used. And because consumer electronics retailers do not collect or analyze information as to components or materials, they lack systems, facilities, personnel, and expertise to store, manage, or evaluate such information if it were now to be supplied. The source of the minerals used in products is not a piece of information that can be created by observing or testing the vendor-manufacturer's factory or the product itself. The source of materials is a data point that can only be captured at the origin – far from the influence or control of the retailer at the end of the supply chain; and there is no mature infrastructure to pass this data up the supply chain.

Hence, even where a retailer actively addresses the design of a product by contract, it would not be a reasonable interpretation of the law, and would degrade rather than enhance reporting accuracy, to expect that a retailer's due diligence could extend down to mining, smelting and other steps that are entirely beyond the retailer's necessary business inquiry or expertise. Retailers rely on their manufacturer vendors to address any such subjects. The information retailers seek and obtain concerns manufacturing and product outcomes, not component or raw material sourcing specifics. Nor do retailers have any infrastructure or expertise to verify, much less audit, whatever information is provided by their vendor.

B. A Regulation Imposing Obligations On Consumer Electronics Retailers Who Do Not Manufacture Would Impose Substantive Course Of Business Obligations Beyond Any Contained In Or Reasonably Contemplated By Section 1502.

It is well established in the record of this rulemaking, and discussed at length at the SEC's Roundtable, that even the most common of products may have diverse components as to which the sourcing shifts and varies over time, and that electronics products have large numbers of components from multiple sources. Aside from the very specific instances noted as to testing of the final product and inspection of the final factory floor as to safety and labor practices, there has been no reason, in law or public policy, for retailers who do not manufacture products themselves to look beyond the representations of their vendors. Unless the retailer customarily specifies the materials to be used and their sourcing, any due diligence and audit requirements in these areas would be novel and foreign to existing business conduct. Thus, as CERC and RILA specifically demonstrated in their March 2 comments, the "due diligence" undertakings described by OECD and by public interest organizations in most respects bear no relevance to the business practices of, or management tools available to, retailers who do not themselves manufacture. Similarly and additionally, the "audit" requirements of paragraph (p)(1)(A)(i) bear no relevance to any activity of a consumer electronics retailer *or* to any retailer's present ability to verify facts reported by its vending manufacturer. In imposing such obligations, the SEC would be imposing substantive business, rather than reporting, obligations on retailers, without any delegation from the Congress of the power to do so.

Even if it is determined that the SEC does have delegated authority to require retailers to put into place management structures to look behind and validate assurances of vendors with respect to mineral processing and provenance, there is no existing business foundation on which

such structures can be built. As CERC discusses further below, any such structures, whether established by mandate or voluntarily; or by individual companies or by industry groups; would take time to establish – even where the objective is to establish and to audit a procedure to validate the representations of a retailer's immediate supplier.

III. ANY DUE DILIGENCE REQUIREMENT AS APPLIED TO A RETAILER SHOULD BE PROCEDURAL IN NATURE, BASED ON INFORMATION REASONABLY AVAILABLE TO A RETAILER.

It may seem a tautology to say that a retailer's due diligence should be based on information reasonably available to a retailer, but no such formulation was evident in the Proposed Rule. No tools or procedures are in place, or proximately available to retailers of tens of thousands of complex products, each of which may have thousands of components, to undertake any substantive due diligence as to the conflict minerals status of the materials and components of which they are comprised. Therefore, to the extent that even the most reasonable and limited due diligence obligation may be imposed on consumer electronics retailers, it would take time even to implement the necessary management systems to store and to track in parallel and to cross-reference information as to thousands or tens of thousands of ever-changing products:

- Substantial time and effort would be required to establish, even only on a company level, the management systems, render them operational and commission audits to prepare and support disclosures on SEC forms.
- An audit standard for a reasonable inquiry of the origin of minerals would need to be created and published, and in addition a marketplace of trained auditors to this standard would need to be created.

- Data gathering tools that roll up mineral origin information to an item level would need to be created for the retail industry – current questionnaires and corresponding data roll-up tools stop at the supplier, rather than item, level.
- Data reporting systems would need to be integrated into retailers' existing systems to allow traceability of minerals on an SKU level. The SKUs offered in any retailer's assortment are under constant change.
- A certification system that could with a level of certainty trace the origin of minerals to smelters would need to mature.
- These steps would need to be repeated and rolled out within retail companies' disparate and unconnected supply chains (for example for issuers with more than one retail brand with a spate of sourcing operations), and within the supply chains of suppliers and sub-component suppliers.

IV. THE INFORMATION CONVEYED AT THE SEC'S PUBLIC ROUNDTABLE DISCUSSION CONFIRMS THAT "DUE DILIGENCE" IN THE CASE OF RETAILERS, WHETHER MANDATED OR VOLUNTARY, SHOULD BE PROCEDURAL RATHER THAN SUBSTANTIVE, SHOULD FOCUS ON RELIABILITY OF INFORMATION FROM IMMEDIATE VENDORS, SHOULD AVOID DUPLICATION, AND SHOULD RECOGNIZE THE NEED TO PHASE IN NEW MANAGEMENT AND REPORTING STRUCTURES.

CERC and its members recognize a public policy obligation, based on the goals of Section 1502, to play appropriate roles in helping to ensure that, as expeditiously as is possible, trade in conflict minerals be eliminated to the extent that it supports the insurrection and the atrocities that continue to be identified in the DRC, and to assist in the recovery of the minerals trade that sustains so much of the population. CERC commends the SEC for holding its October 18 public roundtable discussion and for

publishing the full transcript of this discussion.[5] Among the core insights, with respect to due diligence, emerging from the discussion among expert Roundtable participants were these crucial points:

(1) The expectations and metrics for "reasonable" due diligence should depend on a business entity's position in the supply chain and the customary business relationships and practices of any entity so positioned.

(2) To the extent internationally recognized standards of diligence pertain to these expectations, they should be considered safe harbors for auditing and enforcement purposes.

These points were supported by experts from several industries and from public interest groups. As to understanding that an entity's "due diligence" should be established by its position in the supply chain and its customary business procedures, facilities, and expertise:

> **Sandy Merber, GE:** [M]ost importantly, the implementing regulations under Section 1502 should provide issuers with the flexibility to design and execute reasonable [country] of origin inquiries and due diligence processes that are appropriate for their specific situations.[6] *** [T]he rule has to recognize the situation of all of the issuers that have to comply with it; and, that for some issuers, the task is more difficult [than] for other issuers.[7]
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> **Irma Villarreal, Kraft:** [T]his is not something that we can just turn on a dime and start doing for 2012. It's going to take us some time. We don't have the ability to talk to 100,000 suppliers to ensure what and who has conflict minerals. … I don't even have information for you on where the suppliers are in [promotional] items.[8]
>
> **Ben Cohen, Boeing:** [T]he internal compliance architecture for registrants and the vast universe of non-registrant suppliers who will nevertheless be required by end product manufacturers to comply is still maturing.[9] *** [T]he remedial purposes of the Act can be

[5] *See*, http://www.sec.gov/spotlight/conflictminerals/conflictmineralsroundtable101811-transcript.txt ("Transcript").
[6] Transcript, p. 28.
[7] *Id.* at 77-78.
[8] *Id.* at 80.
[9] *Id.* at 103.

served very fully and completely served by something less than perfect knowledge and a complete mapping of the supply chain of complex manufacturers all the way back to a smelter or a refiner.[10] *** [I]t is extraordinarily important in terms of having an efficient audit process, which is not crushing in its expense, to have it focused on the design of the process rather than the content of the report.[11]

Darrel Schubert, Ernst & Young: [T]he [AICPA] has concerns that the SEC's proposed rule on conflict minerals was not clear about the subject matter or objective of the examination; nor was it clear about what criteria management would use in preparing and presenting a subject matter. As to the conflict minerals report, the subject matter might be management's description of their procedures and controls in performing their due diligence process with the auditor expressing an opinion that the procedures described were performed without providing any opinion on whether the effectiveness of such procedures or their compliance with any published standards.[12] *** [U]nless management and the auditor are confident that there are suitable criteria to measure … and examine subject matter against, it will not be possible for a CPA to conduct the engagement.[13]

Darren Fenwick, ENOUGH Project: I would just say from our perspective I've heard a lot about flexibility and not being prescriptive, and we understand that point.[14] *** [W]e are not asking companies to go run around the Congo and go to the mines.[15] *** Well based on the systems that GE, for example, has in place, a reasonable person … similarly situated, could come to the same conclusions, so not judging the actual systems that were used, but just sort of making sure that the company is actually living up to the systems they themselves put in place.[16]

As to the recognition of OECD due diligence as a "safe harbor," *see* Mr. Merber at 29, Ms. Simelane at 32, Mr. Davis at 40, Mr. Fenwick and Mr. Reiss at 136-138, and Mr. Cohen at 109 and 138-39.

[10] *Id.* at 131.
[11] *Id.* at 146.
[12] *Id.* at 127.
[13] *Id.* at 129.
[14] *Id.* at 136.
[15] *Id.* at 137.
[16] *Id.* at 148-9.

V. IT WOULD BE UNREASONABLE AND COUNTERPRODUCTIVE TO INTERPRET THE LAW TO APPLY TO RETAIL SALE OF A PRODUCT THAT IS ALSO AVAILABLE TO OTHER RETAILERS, EVEN WHERE THE PRODUCT IS PROCURED BY CONTRACT.

In the event Section 1502 is ultimately found to apply to issuers who are not manufacturers, the requirements of this section should not be applied to any product that is substantially available to other retailers:[17]

- That the product is available to more than one retailer confirms that the obligation for product manufacture and sourcing of materials lies with the manufacturer, independent of any "contract."
- Any *independent* due diligence by the contracting retailers, *beyond relying on information provided by the manufacturer,* would either lead to confusion of investors, if the outcome differed from that reached by the manufacturer or by another retailer, or be redundant to the manufacturer's own conclusion.

Hence, it would seem inevitable that two retailers dealing with the same manufacturer could make different conflict mineral "due diligence" determinations about essentially the same product, from the same factory. CERC members do not believe that Section 1502 is directed to receiving guesswork and assumptions that cannot possibly be verified, and that can only confuse, rather than enlighten, public and investor discourse.

Because retailers have neither proximity nor insight to production processes, it would be arbitrary, capricious, and contrary to the rationale for Section 1502 to label retailers who do not run factories as in the business of having "manufactured" products. CERC members and many

[17] This is most obvious in the case of "off the shelf" products, which are branded, designed and manufactured before being offered to retailers. However, many or most other products that are offered to retailers, even under "private label" circumstances, are identical, in the functional respects that relate to use of conflict minerals, to the products offered under the manufacturer's own brand, or to the products offered by that manufacturer to other retailers as private label products.

other retailers have little or no exposure to production and raw material sourcing specifics, and have no way to reliably obtain or verify such specifics. Therefore, nothing in the contracting process for retail finished consumer goods can justify a requirement for reporting that would be based on unverifiable information or on speculation.

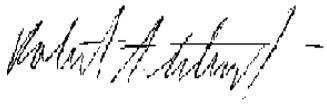
CONCLUSION

CERC appreciates this opportunity to provide comments on the proposed rule to implement the conflict mineral provisions in Section 1502 of the Dodd-Frank Act. We and our members support efforts to combat trade in conflict minerals and to stop the atrocities in the DRC. We believe those goals can be achieved without unduly burdening companies and undermining legitimate commerce.

Respectfully submitted,

CONSUMER ELECTRONICS RETAILERS COALITION

Of Counsel:



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