SECURITIES AND EXCHANGE COMMISSION

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Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY L. SCHAPIRO, CHAIRMAN

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

(45 Documents)

Commissioner Gallagher
not participating

**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

**August 19, 2011**

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| **In re** | : | |
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| **Puda Coal, Inc.** | : | **ORDER OF SUSPENSION OF TRADING** |
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| **File No. 500-1** | : | |
| | : | |

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Puda Coal, Inc. ("Puda") because (1) Puda's auditors resigned on July 7, 2011 and stated that further reliance should no longer be placed on its previously issued audit reports dated March 31, 2010 and March 16, 2011; and (2) the Audit Committee of Puda's Board of Directors has announced that it has preliminarily concluded that evidence supports the allegation that there were transfers by Puda's Chairman in subsidiary ownership that were inconsistent with disclosure made by the Company in its public securities filings. Puda is quoted on the OTC Pink Market operated by the OTC Markets Group Inc. under the symbol PUDA.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the company listed above.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the companies listed above is suspended for the period from 5:30 p.m. EDT, August 19, 2011, through 11:59 p.m. EDT, on September 1, 2011.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67586 / August 2, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14970

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| IN THE MATTER OF ROBERT T. MCALLISTER, ESQ., Respondent. | ORDER OF FORTHWITH SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE |

I.

The Securities and Exchange Commission ("Commission") deems it appropriate to issue an order of forthwith suspension of Robert T. McAllister pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 200.102(e)(2)].[1]

II.

The Commission finds that:

1. McAllister was an attorney admitted to practice law in the State of Colorado.

2. McAllister appeared and practiced before the Commission as an attorney in connection with several Commission investigations.

3. Following an investigation by the Colorado Office of Attorney Regulation, McAllister signed a stipulation in which he admitted to misconduct and agreed to be disbarred. The misconduct stemmed from two different matters, one in which he converted approximately $5,000 in client funds to pay for operating expenses of his law firm, and a second in which he converted $100,000 in client funds for his personal use. The conversion in the second case also violated a state court order freezing his client's assets.

[1] Rule 102(e)(2) provides in pertinent part: "Any attorney who has been suspended or disbarred by a court of the United States or of any State; . . . shall be forthwith suspended from appearing or practicing before the Commission."

4. On June 6, 2011, McAllister signed a stipulation stating that his misconduct was knowing, dishonest, and violated Colorado Rules of Professional Conduct 3.4(c) and 8.4(c).

5. On June 7, 2011, the Supreme Court of the State of Colorado entered an order disbarring McAllister, based on the stipulation he had signed. The disbarment was effective July 8, 2011.

III.

In view of the foregoing, the Commission finds that McAllister was an attorney who has been disbarred from practicing law within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice. Accordingly, it is ORDERED that Robert T. McAllister is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67587 / August 2, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14971

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| In the Matter of<br><br>Falcon Oil & Gas Co., Inc.,<br>First Dearborn Income Properties, LP,<br>Franklin American Corp.,<br>Future Healthcare, Inc.,<br>Gandalf Technologies, Inc.,<br>Geo International Corp.,<br>Geoalert, Inc., and<br>GiraSolar, Inc.,<br><br>Respondents. | ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934 |

## I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Falcon Oil & Gas Co., Inc., First Dearborn Income Properties, LP, Franklin American Corp., Future Healthcare, Inc., Gandalf Technologies, Inc., Geo International Corp., Geoalert, Inc., and GiraSolar, Inc.

## II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Falcon Oil & Gas Co., Inc. (CIK No. 215797) is a delinquent Colorado corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Falcon Oil & Gas is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it

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filed a Form 10-K for the period ended January 31, 1996, which reported a net loss of over $296,000 for the prior six months.

2. First Dearborn Income Properties, LP (CIK No. 806182) is a cancelled Delaware limited partnership located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). First Dearborn Income Properties is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2001, which reported a net loss of over $106,000 for the prior twelve months.

3. Franklin American Corp. (CIK No. 845094) is a dissolved Tennessee corporation located in Franklin, Tennessee with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Franklin American is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 31, 1998.

4. Future Healthcare, Inc. (CIK No. 865072) is a cancelled Ohio corporation located in Cincinnati, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Future Healthcare is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1994. On December 20, 1995, Future Healthcare filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Southern District of Ohio, and the case was terminated on January 25, 2012.

5. Gandalf Technologies, Inc. (CIK No. 355876) is an Ontario corporation located in Nepean, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Gandalf Technologies is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended March 31, 1997, which reported a net loss of over $46 million for the prior twelve months.

6. Geo International Corp. (CIK No. 702993) is a void Delaware corporation located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Geo International is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 1993, which reported a net loss of over $34 million for the prior nine months.

7. Geoalert, Inc. (CIK No. 1082540) is a permanently revoked Nevada corporation located in Berea, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Geoalert is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 2001, which reported a net loss of over $431,000 for the prior nine months. As of July 31, 2012, the company's stock (symbol "GEOT") was traded on the over-the-counter markets.

8. GiraSolar, Inc. (CIK No. 1307901) is a forfeited Delaware corporation located in Deventer, The Netherlands with a class of securities registered with the Commission

pursuant to Exchange Act Section 12(g). GiraSolar is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2007, which reported a net loss of over $1 million for the prior nine months. As of July 31, 2012, the company's stock (symbol "GRSR") was traded on the over-the-counter markets.

B. DELINQUENT PERIODIC FILINGS

9. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

10. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

11. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

## III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

## IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Kevin M. O'Neill

**By: Kevin M. O'Neill**
**Deputy Secretary**

Commissioner Walter
Commissioner Gallagher
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67590 / August 2, 2012

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3398 / August 2, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14972

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| In the Matter of<br><br>KENNETH E. LONCHAR, CPA,<br><br>Respondent. | ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS |

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Kenneth E. Lonchar, CPA ("Respondent" or "Lonchar") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

## II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Lonchar, age 54, has been a certified public accountant licensed to practice in the State of Idaho. This license lapsed in 1995. He served as Chief Financial Officer ("CFO") of Veritas Software Corporation ("Veritas") from April 1997 until his resignation in October 2002.

2. Veritas, now a wholly owned subsidiary of Symantec Corporation, was a software company headquartered in Mountain View, California that created and licensed data storage software. At all relevant times, Veritas' common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and was quoted on the Nasdaq National Market.

3. On July 20, 2012, a final judgment was entered against Lonchar, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Leslie, et al., Civil Action No. C 07-3444-CW, in the United States District Court for the Northern District of California. Lonchar was also ordered to pay $300,000 in disgorgement representing profits gained as a result of the conduct alleged in the amended complaint and prejudgment interest thereon, and a $100,000 civil money penalty.

4. The Commission's amended complaint alleged Lonchar knowingly participated in two schemes to manipulate Veritas' publicly reported revenues and earnings. The complaint alleged that Veritas artificially inflated reported revenues by approximately $20 million in connection with a software sale to America Online, Inc. ("AOL") in 2000. According to the complaint, Lonchar, Veritas' CFO, applied an accounting treatment to the transaction that did not comply with generally accepted accounting principles ("GAAP"). The complaint also alleged that Lonchar and others concealed the true nature of the transaction with AOL, which allowed Veritas to artificially inflate its reported revenue. The complaint further alleged that from at least 2000 until his resignation in 2002, Lonchar and others also applied three non-GAAP accounting practices to "smooth" artificially Veritas' financial results and that they concealed these manipulations from Veritas' independent auditors.

## IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Lonchar's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Lonchar is suspended from appearing or practicing before the Commission as an accountant.

B. After five (5) years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

Commissioner Walter not participating

**UNITED STATES OF AMERICA**
**Before the**
**U.S. SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67591 / August 2, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-11317**

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| **In the Matter of**<br><br>**Putnam Investment Management, LLC,**<br><br>**Respondent.** | **ORDER AUTHORIZING THE TRANSFER OF RESIDUAL FUNDS AND ANY FUTURE FUNDS RECEIVED BY THE FAIR FUND TO THE U.S. TREASURY, DISCHARGING THE FUND ADMINISTRATOR, AND TERMINATING THE FAIR FUND** |

On November 13, 2003, the U.S. Securities and Exchange Commission ("Commission") issued an Order Making Findings and Imposing Partial Relief, Including a Final Censure, Remedial Undertakings and a Cease and Desist Order ("November 2003 Order") pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940 against Putnam Investment Management, LLC ("Putnam"). On April 8, 2004, the Commission issued an Order Making Findings and Imposing Supplemental Remedial Sanctions ("April 2004 Order") pursuant to Section 203(e) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act of 1940 against Putnam (together with the November 2003 Order, "Putnam Settlement Orders"). The April 2004 Order also required that Putnam retain an Independent Distribution Consultant ("IDC") to develop a plan to distribute the disgorgement, penalty, and additional payment as part of a Fair Fund to harmed investors to compensate the harmed investors for: (i) their share of losses as calculated by the Independent Assessment Consultant; and (ii) a proportionate share of advisory fees paid by funds that suffered losses during the period of the market timing. The Putnam Settlement Orders directed Putnam to pay $50 million in civil penalties, $5 million in disgorgement, plus an additional amount, which was calculated by the Independent Assessment Consultant to be $42,914,120.

On July 20, 2007, the Commission issued an Order Approving a Modified Distribution Plan ("Modified Plan") after receiving comments in response to the original Notice of Proposed Distribution Plan. The Modified Plan appointed Putnam Fiduciary Trust Co., Inc. ("PFTC") as the Fund Administrator and provided for the disbursement of the Fair Fund's $97.9 million, plus interest along with $55.6 million paid in a related action brought by the Commonwealth of Massachusetts.

The Fair Fund, comprised of funds paid to the Commission and the Commonwealth of Massachusetts, plus interest, ultimately distributed $170,324,147.85 to beneficial owners, including distributions to approximately 1.8 million individual investors.[1] Eighty-six percent of the Fair Fund was distributed, and the average payment to individual investors was approximately $55. Additionally, fifty-three mutual funds received payments in the residual phase.[2]

Section VII, Paragraph 55 of the Modified Plan provided that the Fair Fund would be eligible for termination 30 days after the final distribution to investors and when the resolution of uncashed or unclaimed funds occurred and the final accounting by the Fund Administrator was submitted and approved by the Commission. The last check was issued in December of 2011, and no further distributions have been made since then; nor have there been any disputes or reports of uncashed or unclaimed checks.

The Fund Administrator submitted a Final Accounting of the Fair Fund pursuant to Rule 1105(f) of the Commission's Rules on Fair Fund and Disgorgement Plans. The Final Accounting was approved by the Commission. According to the Final Accounting, all liabilities have been satisfied and an amount of $1,380.84 remains in the Fair Fund.

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1 By a Corrected Order Directing Disbursement of Fair Fund dated August 15, 2008, the Commission authorized a first distribution in the amount of $33,778,470.39. See Exchange Act Release No. 58369A. By an Order Directing Disbursement of Fair Fund dated December 2, 2008, the Commission authorized a second distribution in the amount of $46,515,302.38. See Exchange Act Release No. 59041. By an Order Directing Disbursement of Fair Fund dated February 25, 2009, the Commission authorized a third distribution in the amount of $28,128,811.12. See Exchange Act Release No. 59447. By an Order Directing Disbursement of Fair Fund dated May 28, 2009, the Commission authorized a fourth distribution in the amount of $4,245,929.44. See Exchange Act Release No. 59994. By an Order Directing Disbursement of Fair Fund dated July 31, 2009, the Commission authorized a fifth distribution in the amount of $19,354,093.35. See Exchange Act Release No. 60412. By an Order Directing Disbursement of Fair Fund dated December 2, 2009, the Commission authorized a sixth distribution in the amount of $4,356,590.74. See Exchange Act Release No. 61098. By an Order Directing Disbursement of Fair Fund dated February 2, 2010, the Commission authorized a seventh distribution in the amount of $4,214,238.67. See Exchange Act Release No. 61463. By an Order Directing Disbursement of Fair Fund dated November 1, 2010, the Commission authorized an eighth distribution in the amount of $2,641,841.14. See Exchange Act Release No. 63221. By an Order Directing Disbursement of Fair Fund dated March 4, 2011, the Commission authorized a ninth distribution in the amount of $1,045,492.65. See Exchange Act Release No. 64034. By an Order Directing Disbursement of Fair Fund Residual dated September 1, 2011, the Commission authorized a distribution of residual funds. See Exchange Act Release No. 65243. However, because of an error as to the amount of the residual distribution in the September 1, 2011 Order, the Commission issued an Amended Order Directing Disbursement of Fair Fund Residual dated December 12, 2011, authorizing a distribution of residual funds in the amount of $46,077,445.85. See Exchange Act Release No. 65243A.

2 Id.

ACCORDINGLY, IT IS ORDERED that:

1. The $1,380.84 balance in the Fair Fund and any future funds received by the Fair Fund shall be transferred to the U.S. Treasury;
2. The Fund Administrator is hereby discharged; and
3. The Fair Fund is terminated.

By the Commission.

Elizabeth M. Murphy
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

Commissioner Aguilar not participating

**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**
**Release No. 3441 / August 3, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14973**

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| **In the Matter of**<br><br>**Consultiva Internacional, Inc.,**<br><br>**Respondent.** | **ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER** |

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Consultiva Internacional, Inc. ("Consultiva" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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## III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

### Summary

From June 2005 through December 2010, Consultiva, a registered investment adviser, failed to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules, as required by Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. In September 2005, the Commission's exam staff alerted Consultiva to numerous deficiencies regarding its compliance program including the design of the firm's compliance manual, the competency of its Chief Compliance Officer ("CCO"), and inaccuracies and inconsistencies with its Form ADV. In December 2010, when the Commission exam staff returned to Consultiva to conduct another examination, it found that Consultiva had not taken all of the necessary remedial steps to satisfy its compliance obligations. Similarly, from at least June 2005 through December 2010, Consultiva failed to properly enforce its written code of ethics, as required under Section 204A of the Advisers Act and Rule 204A-1 thereunder because it did not collect and retain the required periodic securities reports from Consultiva's access persons.

### Respondent

1. **Consultiva**, headquartered in Guaynabo, Puerto Rico, was founded in 1999 and registered with the Commission as an investment adviser in February 2000. In its most recent Form ADV filed on June 22, 2011, Consultiva states that is has 86 clients, and nearly $695 million in assets under management. The firm has sixteen employees, all of whom it deems to be access persons under Rule 204A-1 of the Advisers Act.

### Background

2. Effective October 5, 2004, Rule 206(4)-7, promulgated under Section 206(4) of the Advisers Act, requires that a registered investment adviser: (1) adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and its rules; (2) review the adequacy of the written policies and procedures and the effectiveness of their implementation on at least an annual basis; and (3) designate a CCO.

3. Effective January 7, 2005, Rule 204A-1, promulgated under Section 204A of the Advisers Act, requires that a registered investment adviser establish, maintain and enforce a written code of ethics that includes, at a minimum: (1) a standard of business conduct reflecting the adviser's and its supervised persons' fiduciary obligations; (2) the requirement that all staff comply with the federal securities laws; (3) the requirement that access persons submit for review a securities transaction report on a quarterly basis and a securities holdings report upon hiring and then at least annually thereafter, and submit for pre-approval any purchase of

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

securities in an initial public offering or limited offering; (4) the requirement that supervised persons report any code violations to the CCO; and (5) the requirement that the code and any amendments are provided to supervised persons and the supervised persons provide a written acknowledgement of their receipt.

4. The Commission's exam staff conducted an examination of Consultiva in June 2005 and issued a deficiency letter in September 2005 noting several issues. These issues included Consultiva's failure to maintain a compliance manual adequately tailored to its business. The exam staff noted to Consultiva that its compliance manual appeared tailored to broker-dealer compliance rather than Consultiva's investment advisory business. The exam staff also questioned the CCO's ability to adequately oversee Consultiva's compliance operations due to his lack of familiarity with the Advisers Act and failure to obtain the proper training.

5. The exam staff also noted in its deficiency letter to Consultiva several inaccuracies and inconsistencies in the firm's Form ADV as compared to its investment advisory business.

6. In December 2010, the Commission's exam staff began another examination of Consultiva. That exam revealed that, while Consultiva had undertaken certain corrective steps in response to the 2005 exam findings, it did not rectify the above compliance deficiencies.

7. The staff's December 2010 examination also revealed additional problems with Consultiva's compliance program. First, from 2008 through 2010, Consultiva did not adequately conduct, or did not sufficiently document, annual reviews of its compliance program.

8. Second, from at least June 2005 through December 2010, Consultiva did not follow all of the policies and procedures established in its code of ethics. Consultiva did not document whether it had obtained from each of its access persons annual reports of their securities holdings. Consultiva also did not timely collect and properly review, for at least one quarter, quarterly reports of personal securities transactions by its access persons. Moreover, on at least one occasion, Consultiva's CCO reviewed and signed off on his own quarterly report of personal securities transactions.

9. In January 2011, in response to the Commission exam staff's deficiency letter, Consultiva began taking steps to rectify the unresolved issues from the 2005 and 2010 exams.

## Violations

10. As a result of the conduct described above, Consultiva willfully[2] violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which requires, among other

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[2] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C.

things, that a registered investment adviser: (1) implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules; and (2) review at least annually its written policies and procedures and the effectiveness of their implementation.

11. As a result of the conduct described above, Consultiva willfully violated Section 204A of the Advisers Act and Rule 204A-1 thereunder, which requires that a registered investment adviser maintain and enforce a written code of ethics that at a minimum includes, among other things, provisions requiring that: (1) all staff comply with the federal securities laws; and (2) access persons submit for review a securities transaction report on a quarterly basis and a securities holdings report upon hiring and then at least annually thereafter.

## Consultiva's Remedial Efforts

12. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Consultiva and cooperation afforded the Commission staff. Specifically, during the Commission staff's investigation, Consultiva hired a compliance consultant to evaluate Consultiva's compliance practices and procedures and Consultiva is implementing the compliance consultant's recommendations.

## Undertakings

Respondent Consultiva has undertaken the following:

13. Independent Consultant. With respect to the retention of an independent consultant, Respondent has agreed to the following undertakings:

a. Consultiva shall retain, within (30) days of the entry of this Order, the services of an independent compliance consultant (the "Independent Consultant") that is not unacceptable to the Commission staff. The Independent Consultant's compensation and expenses shall be borne exclusively by Consultiva.

b. Consultiva shall provide to the Commission staff, within thirty (30) days of the entry of this Order, a copy of the engagement letter detailing the Independent Consultant's responsibilities, which shall include comprehensive compliance reviews as described below in this Order.

c. Consultiva shall require that the Independent Consultant conduct by the end of the fourth quarter of 2012 and the end of the fourth quarter of 2013 comprehensive reviews of Consultiva's supervisory, compliance, and other policies and procedures reasonably designed to detect and prevent breaches of the federal securities laws by Consultiva and its employees (the "Reviews"), including the adequacy of: (1) Consultiva's policies and procedures required by Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder; and (2)

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Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

Consultiva's written code of ethics and compliance with the requirements of Section 204A of the Advisers Act and Rule 204A-1 thereunder.

d. Consultiva shall require that, within forty-five (45) days from the end of the applicable quarterly period, the Independent Consultant shall submit a written and detailed report of its findings to Consultiva and to the Commission staff (the "Report"). Consultiva shall require that each Report include a description of the review performed, the names of the individuals who performed the review, the conclusions reached, the Independent Consultant's recommendations for changes in or improvements to Consultiva's policies and procedures and/or disclosures to clients, and a procedure for implementing the recommended changes in or improvements to Consultiva's policies and procedures and/or disclosures.

e. Consultiva shall adopt all recommendations contained in each Report within sixty (60) days of the applicable Report; provided, however, that within forty-five (45) days after the date of the applicable Report, Consultiva shall in writing advise the Independent Consultant and the Commission staff of any recommendations that Consultiva considers to be unduly burdensome, impractical, or inappropriate. With respect to any recommendation that Consultiva considers unduly burdensome, impractical or inappropriate, Consultiva need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose.

f. As to any recommendation with respect to Consultiva's policies and procedures on which Consultiva and the Independent Consultant do not agree, Consultiva and the Independent Consultant shall attempt in good faith to reach an agreement within sixty (60) days after the date of the applicable Report. Within fifteen (15) days after the conclusion of the discussion and evaluation by Consultiva and the Independent Consultant, Consultiva shall require that the Independent Consultant inform Consultiva and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Consultiva considers to be unduly burdensome, impractical, or inappropriate. Consultiva shall abide by the determinations of the Independent Consultant and, within sixty (60) days after final agreement between Consultiva and the Independent Consultant or final determination by the Independent Consultant, whichever occurs first, Consultiva shall adopt and implement all of the recommendations that the Independent Consultant deems appropriate.

g. Within ninety (90) days of Consultiva's adoption of all of the recommendations in a Report that the Independent Consultant deems appropriate, as determined pursuant to the procedures set forth herein, Consultiva shall certify in writing to the Independent Consultant and the Commission staff that Consultiva has adopted and implemented all of the Independent Consultant's recommendations in the applicable Report. Unless otherwise directed by the Commission staff, all Reports, certifications, and other documents required to be provided to the Commission staff shall be sent to Chad Alan Earnst, Assistant Regional Director, Asset Management Unit, Miami Regional Office, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, FL, 33131, or such other address as the Commission staff may provide.

h. Consultiva shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to such of its files, books, records, and personnel as are reasonably requested by the Independent Consultant for review.

i. To ensure the independence of the Independent Consultant, Consultiva: (1) shall not have the authority to terminate the Independent Consultant or substitute another independent compliance consultant for the initial Independent Consultant, without the prior written approval of the Commission staff; and (2) shall compensate the Independent Consultant and persons engaged to assist the Independent Consultant for services rendered pursuant to this Order at their reasonable and customary rates.

j. Consultiva shall require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two (2) years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Consultiva, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which the Independent Consultant is affiliated or of which the Independent Consultant is a member, and any person engaged to assist the Independent Consultant in the performance of the Independent Consultant's duties under this Order shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Consultiva, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two (2) years after the engagement.

14. Recordkeeping. Consultiva shall preserve for a period of not less than six (6) years from the end of the fiscal year last used, the first two (2) years in an easily accessible place, any record of Consultiva's compliance with the undertakings set forth in this Order.

15. Notice to Advisory Clients. Within ten (10) days of the entry of this Order, Consultiva shall post prominently on its principal Web site a summary of this Order in a form and location acceptable to the Commission staff, with a hyperlink to the entire Order. Consultiva shall maintain the posting and hyperlink on Consultiva's Web site for a period of twelve (12) months from the entry of this Order. Within thirty (30) days of the entry of this Order, Consultiva shall provide a copy of the Order to each of Consultiva's existing advisory clients as of the entry of this Order via mail, e-mail, or such other method as may be acceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff.

16. Deadlines. For good cause shown, the Commission staff may extend any of the procedural dates relating to the undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

17. Certifications of Compliance by Respondent. Consultiva shall certify, in writing, compliance with its undertakings set forth above. The certification shall identify the

undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Consultiva agrees to provide such evidence. The certification and supporting material shall be submitted to Chad Alan Earnst, Assistant Regional Director, Asset Management Unit, Miami Regional Office, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, FL, 33131, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

## IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Consultiva's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Consultiva cease and desist from committing or causing any violations and any future violations of Sections 204A and 206(4) of the Advisers Act and Rules 204A-1 and 206(4)-7 promulgated thereunder.

B. Respondent Consultiva is censured.

C. Respondent Consultiva shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $35,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

> (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
> (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
> (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:
>
> > Enterprise Services Center
> > Accounts Receivable Branch
> > HQ Bldg, Room 181, AMZ-341
> > 6500 South MacArthur Boulevard
> > Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Consultiva as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Chad Alan Earnst, Assistant Regional

Director, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, FL 33131.

D. Respondent Consultiva shall comply with the undertakings enumerated in Section III, paragraphs 13 to 17 above.

By the Commission.

Elizabeth M. Murphy
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67611 / August 7, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14850

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|---|---|
| In the Matter of<br><br>Timothy T. Page,<br><br>Respondent. | ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 |

I.

On April 17, 2012, the Securities and Exchange Commission ("Commission") issued an Order Instituting Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Notice of Hearing against Timothy T. Page ("Page" or "Respondent") (Rel. No. 34-66822).

In connection with these proceedings, Page has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of settling these proceedings and any other proceedings brought by or on behalf of the Commission or in which the Commission is a party, prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. § 201.100 et seq., and without admitting or denying the Commission's findings contained herein, except as to the jurisdiction of the Commission over him and over the subject matter of these proceedings, and the findings contained in Section II. 3, which are admitted, Respondent Page consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

II.

On the basis of this Order and the Respondent's Offer, the Commission finds that:

1. Respondent Page, age 62, is a citizen of Great Britain who emigrated to the United Sates and later resided in Austin, Texas during 2004. In 2005, he moved to Malibu,

California. Page was the general partner of Page Properties LP ("Page Properties"), a limited partnership formed in Texas in 2000.

2. During 2003 and 2004, Page was not registered as, or associated with a broker or dealer that was registered with the Commission.

3. On April 10, 2012, the United States District Court for the Northern District of Texas entered an amended judgment against Page permanently enjoining him from future violations of Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") and Section 15(a)(1) of the Exchange Act. *See SEC v. Phillip W. Offill, Jr., et al.*, Civil Action No. 07-cv-1643-D (N.D. Texas).

4. The Commission's complaint alleged that Page and others violated Sections 5(a) and 5(c) of the Securities Act and Section 15(a)(1) of the Exchange Act. The complaint alleged that Page failed to comply with the registration requirements of the federal securities laws by offering and selling the securities of two companies when no registration statements were filed or in effect for their sales transactions. The complaint also alleged that Page located companies that were interested in raising money by selling shares to investors through the public stock market and acted as an underwriter. The complaint alleged that Page purchased shares from two of the companies with a view to offer or sell the shares for the companies in connection with the distribution of the shares to the public and immediately resold them to public investors through brokerage accounts in his own name and the name of Page Properties, which was the primary means through which Page intended to finance the companies.

5. The complaint also alleged that in December 2003, Page entered into an agreement with Ecogate Inc. ("Ecogate") to raise money for the company through a public stock offering under Rule 504 of Regulation D. In May 2004, Ecogate issued 4,200,000 shares to Page. Page deposited 1,000,000 of the Ecogate shares into a brokerage account in his own name and 1,000,000 shares into a brokerage account in the name of Page Properties. From May through December 2004, Page offered and sold approximately 1.7 million Ecogate shares from these accounts for proceeds of approximately $188,276.

6. The complaint also alleged that in February 2004, Page entered into an agreement with Media International Concepts, Inc. ("Media International") to raise money for the company through a public stock offering under Rule 504 of Regulation D. In May 2004, Media International issued 2,000,000 shares to Page. He deposited 1,000,000 Media International shares into his brokerage account and 1,000,000 Media International shares into the brokerage account of Page Properties. Between May 2004, and January 2005, Page offered and sold approximately 1,748,000 Media International shares from these accounts for proceeds of approximately $99,946.

7. The complaint also alleged that Page acted as an unregistered dealer by engaging in the business of underwriting public securities offerings and engaged in the regular business of effecting transactions in securities by buying and selling securities for his own accounts and for

the accounts of Page Properties. The complaint also alleged that Page used the mails or the means or instrumentalities of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of securities while he was not registered with the Commission as a broker-dealer or associated with a broker-dealer registered with the Commission.

## III.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in the Respondent's Offer.

Accordingly, it is ORDERED that pursuant to Section 15(b)(6) of the Exchange Act, Respondent Page be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67615 / August 7, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14977

| In the Matter of | |
|---|---|
| Flagship International Holding, Ltd.,<br>Fortune Credit & Insurance Services, Inc. (f/k/a Saratoga International Holdings Corp.),<br>Fracmaster, Ltd.,<br>Franklyn Resources I, Inc.,<br>FutureOne, Inc.,<br>Galaxy Energy Corp., and<br>Global Light Telecommunications, Inc.,<br><br>Respondents. | ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934 |

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Flagship International Holding, Ltd., Fortune Credit & Insurance Services, Inc. (f/k/a Saratoga International Holdings Corp.), Fracmaster, Ltd., Franklyn Resources I, Inc., FutureOne, Inc., Galaxy Energy Corp., and Global Light Telecommunications, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Flagship International Holding, Ltd. (CIK No. 1133201) is a permanently revoked Nevada corporation located in Omaha, Nebraska with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Flagship

International Holding is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB/A registration statement on April 17, 2001.

2. Fortune Credit & Insurance Services, Inc. (f/k/a Saratoga International Holdings Corp.) (CIK No. 1092915) is a permanently revoked Nevada corporation located in Kirkland, Washington with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Fortune Credit & Insurance Services is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended July 31, 2001, which reported a net loss of over $176,000 for the prior nine months. As of August 6, 2012, the company's stock (symbol "FCRI") was traded on the over-the-counter markets.

3. Fracmaster, Ltd. (CIK No. 1057876) is an Alberta corporation located in Calgary, Alberta, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Fracmaster is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 40-F for the period ended December 31, 1997.

4. Franklyn Resources I, Inc. (CIK No. 1093170) is a permanently revoked Nevada corporation located in Denver, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Franklyn Resources I is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB/A for the period ended May 31, 2000, which reported a net loss of over $4,000 for the prior twelve months.

5. FutureOne, Inc. (CIK No. 1059838) is a permanently revoked Nevada corporation located in Colorado Springs, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FutureOne is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2002, which reported a net loss of over $83,000 for the prior three months. On March 29, 2001, FutureOne filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of Colorado, and the case was terminated on March 11, 2010. As of April 20, 2012, the company's stock (symbol "FUTO") was traded on the over-the-counter markets.

6. Galaxy Energy Corp. (CIK No. 1132784) is a delinquent Colorado corporation located in Denver, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Galaxy Energy is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended August 31, 2008, which reported a net loss of over $8.8 million for the prior nine months. On March 14, 2008, Galaxy Energy filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of Colorado, and the case was terminated on April 25, 2011. As of August 6, 2012, the company's stock (symbol "GAXIQ") was traded on the over-the-counter markets.

7. Global Light Telecommunications, Inc. (CIK No. 1054183) is a Yukon corporation located in Vancouver, British Columbia, Canada with a class of securities

registered with the Commission pursuant to Exchange Act Section 12(g). Global Light Telecommunications is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 40-F/A for the period ended December 31, 2000, which reported a net loss of more than $30 million for the prior twelve months. As of August 6, 2012, the company's stock (symbol "GBTI") was traded on the over-the-counter markets.

B. DELINQUENT PERIODIC FILINGS

8. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

9. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

10. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

**III.**

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

**IV.**

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3442 / August 7, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14851

In the Matter of

BRIAN J. SMART,

Respondent.

ORDER MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940

I.

On April 18, 2012, the Securities and Exchange Commission ("Commission") instituted public administrative proceedings pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Brian J. Smart ("Smart" or "Respondent").

II.

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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## III.

On the basis of this Order and Respondent's Offer, the Commission finds that

1. Brian J. Smart, 35 years old, is a resident of Lehi, Utah. From at least 2003 to 2009, Smart was the founder and sole member of Smart Assets, LLC, which was an unregistered investment adviser.

2. On June 8, 2011, in the civil action titled Securities and Exchange Commission v. Brian J. Smart, et al., Civil Action Number 2:09-CV-00224, in the United States District Court for the District of Utah, the Court entered a final judgment against Smart and his company Smart Assets, LLC. The Court found, *inter alia*, that during the period 2003 through 2008, Smart and Smart Assets, LLC misappropriated over $2.05 million from investors. The Court's final judgment against Smart and Smart Assets permanently enjoins them from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and orders them to pay $2,059,077 in disgorgement, $597,426 in prejudgment interest, and a $2,059,077 civil penalty.

## IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Smart's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Smart be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67614 / August 7, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14976**

**In the Matter of**

**TRAVIS RICHEY,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Travis Richey ("Richey" or "Respondent").

**II.**

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Between November 2007 and July 2008, Respondent was the control person of Blue Investments, LLC ("Blue Investments"). Respondent has never been registered with the Commission or any other regulatory agency in any capacity. During the time in which he engaged in the conduct underlying the indictment described below, Respondent acted as an unregistered

broker or dealer in violation of the federal securities laws by selling promissory notes through his company, Blue Investments. Respondent, age 30, is an Arizona resident.

B. ENTRY OF THE CRIMINAL CONVICTION

2. Richey pleaded guilty to one count of operating a fraudulent scheme and artifice in violation of Arizona Revised Statutes (A.R.S.) § 13-2310(A), and two counts of transactions by unregistered dealers or salesmen in violation of A.R.S. § 44-1842, before the Superior Court of Maricopa County, Arizona, in State of Arizona v. Richey (Case No. CR 2010-006712-001DT). On January 20, 2012, a judgment in the criminal case was entered against Richey. He was sentenced to two years imprisonment, seven years probation and ordered to pay restitution of $3,059,495.24.

3. The counts of the criminal indictment to which Richey pleaded guilty alleged, inter alia, that Richey, pursuant to a scheme or artifice to defraud, did knowingly obtain a benefit from investors, by means of false or fraudulent pretenses, representations, promises or material omissions and offered to sell or offered for sale, securities to investors when he was not registered as a securities dealer or salesman.

**III.**

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act.

**IV.**

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as

provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67611 / August 7, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14850**

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| **In the Matter of** <br><br> **Timothy T. Page,** <br><br> **Respondent.** | **ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934** |

## I.

On April 17, 2012, the Securities and Exchange Commission ("Commission") issued an Order Instituting Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Notice of Hearing against Timothy T. Page ("Page" or "Respondent") (Rel. No. 34-66822).

In connection with these proceedings, Page has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of settling these proceedings and any other proceedings brought by or on behalf of the Commission or in which the Commission is a party, prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. § 201.100 et seq., and without admitting or denying the Commission's findings contained herein, except as to the jurisdiction of the Commission over him and over the subject matter of these proceedings, and the findings contained in Section II. 3, which are admitted, Respondent Page consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

## II.

On the basis of this Order and the Respondent's Offer, the Commission finds that:

1. Respondent Page, age 62, is a citizen of Great Britain who emigrated to the United Sates and later resided in Austin, Texas during 2004. In 2005, he moved to Malibu,

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67613 / August 7, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14975

| | |
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| **In the Matter of**<br><br>**SHANE A. MULLHOLAND,**<br><br>**Respondent.** | **ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS** |

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Shane A. Mullholand ("Respondent" or "Mullholand").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of settling these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. § 201.100 et seq., and without admitting or denying the findings contained herein, except as to the Commission's jurisdiction over him and over the subject matter of these proceedings, and the findings contained in paragraph III. 6. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Respondent Mullholand, age 41, resided in Dallas, Texas during 2004. Mullholand was the sole managing member and owner of Dissemination Services LLC. ("Dissemination"), a limited liability company formed in Texas. During the relevant period, neither Mullholand nor Dissemination was registered with the Commission in any capacity.

2. During 2004, Mullholand, through Dissemination, was engaged in the business of buying and selling securities for his own accounts. Mullholand acquired stock, which was issued in the name of Dissemination, in non-public transactions with the issuers, and then sold stock to the public market to raise money for the issuers, himself, and Dissemination. Mullholand and Dissemination held themselves out as professionals who could take companies public and were regular participants in the securities business. During 2004, Mullholand also used the brokerage accounts of Dissemination to purchase and sell securities for their own accounts. By these activities, Mullholand and Dissemination acted as dealers.

3. At all times in which Mullholand engaged in the offer, sale or purchase of securities, he was not registered as a dealer or associated with a dealer registered with the Commission.

4. Section 15(a)(1) of the Exchange Act makes it unlawful for any broker or dealer to use the means of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security unless such broker or dealer is registered with the Commission in accordance with Section 15(b) of the Exchange Act, or in the case of a natural person, is associated with a registered broker-dealer. Section 3(a)(5)(A) of the Exchange Act defines a "dealer" as "any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise."

5. On September 26, 2007, the Commission filed a complaint in the United States District Court for the Northern District of Texas alleging that Mullholand, Dissemination and others violated Sections 5(a) and 5(c) of the Securities Act and Section 15(a)(1) of the Exchange Act. *SEC v. Phillip P. Offill, Jr., et al.*, Civil Action No. 07-cv-1643 (N.D. Tex.). The complaint alleged that Mullholand directly or indirectly through Dissemination offered and sold the securities of American Television & Film Company, Auction Mills, Inc., Custom Designed Compressor Systems, Inc., Ecogate Inc., Media International Concepts, Inc., and Vanquish Productions, Inc., when no registration statements were filed or in effect for their transactions and no exemption from registration applied. The complaint also alleged that Mullholand and Dissemination acted as dealers engaged in the regular business of effecting securities transactions for their own accounts. The complaint also alleged that Mullholand and Dissemination made use of the mails or the means or instrumentalities of interstate commerce to effect transactions in or to induce or attempt to induce the purchase or sale of securities while they were not registered with the Commission as a dealer or associated with a dealer registered with the Commission.

6. On July 30, 2012, the United States District Court for the Northern District of Texas entered a final judgment by consent against Mullholand and Dissemination, permanently enjoining them from future violations of Sections 5(a) and 5(c) of the Securities Act and Section 15(a)(1) of the Exchange Act. *SEC v. Phillip P. Offill, Jr., et al.*, Civil Action No. 07-cv-1643-D (N.D. Tex.).

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in the Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Mullholand be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent or nationally recognized statistical rating organization.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Gallagher
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9348 / August 7, 2012

SECURITIES EXCHANGE ACT OF 1934
Release No. 67612 / August 7, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14974

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| In the Matter of<br><br>LEWIS J. HUNTER,<br><br>Respondent. | ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING |

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Lewis J. Hunter ("Respondent" or "Hunter").

II.

After an investigation, the Division of Enforcement alleges that:

A. **RESPONDENT**

1. Hunter, age 44, is a resident of Detroit, Michigan. From November 15, 2006 through October 19, 2011, Hunter was a registered representative at HD Vest Investment Securities, Inc., d/b/a H.D. Vest Investment Services ("HD Vest"), a registered broker-dealer headquartered in Irving, Texas.

## B. OTHER RELEVANT ENTITIES

1. National Business Concepts, LLC ("NBC") is a Michigan limited liability company, with a principal place of business in Niles, Michigan. NBC's principal business purportedly consists of accounting, bookkeeping, tax preparation, and business consulting and management. While a registered representative at HD Vest, Hunter became a partner at NBC on December 31, 2007. He eventually obtained an approximate 9% ownership interest in NBC in 2010.

2. National Business Concepts International-CME Trade Group, LLC ("NBCI") is a Michigan limited liability company, with a principal place of business in Niles, Michigan. The main purpose of NBCI was to fund the foreign currency trading conducted by International Trade Alliance, LLC. Hunter had signatory authority over some of NBCI's bank accounts and maintained control over its brokerage account.

3. International Trade Alliance, LLC ("ITA") is a Michigan limited liability company, with a principal place of business in Niles, Michigan. The main purpose of ITA was to conduct foreign currency trading. Its only client was NBCI. Hunter maintained control over ITA's bank account.

## C. FRAUDULENT MISAPPROPRIATION SCHEME

1. In or around September 2010, Hunter recommended an investment in a "Canadian bank" to two long-time, elderly clients (collectively, "Victim 1"). Hunter told Victim 1 that the investment would have to be funded and held outside of the HD Vest brokerage account because the investment was not offered on HD Vest's trading platform. Hunter repeatedly assured Victim 1 that the investment was "guaranteed."

2. Unbeknownst to Victim 1, on September 27, 2010, Hunter caused HD Vest to wire $150,000 from Victim 1's brokerage account into a bank account held in the name of NBCI. After being confronted by Victim 1 about the withdrawal of funds, Hunter told Victim 1 that he used the funds to purchase a "Guaranteed Investment Certificate" ("GIC") issued by HSBC Bank Canada. Hunter then provided Victim 1 with a copy of what appeared to be a GIC dated October 28, 2010 (the "2010 GIC") in the amount of $150,000. The 2010 GIC purportedly guaranteed monthly interest payments of 15% for two years.

3. In or around February 2011, Hunter recommended that Victim 1 purchase a second GIC from HSBC Bank Canada in the amount of $100,000. Without prior authorization, Hunter caused HD Vest to wire $100,000 from Victim 1's brokerage account into a bank account in the name of NBCI on February 3, 2011. After being confronted again by Victim 1 over the withdrawn funds, Hunter provided Victim 1 another GIC dated February 14, 2011 (the "2011 GIC") in the amount of $100,000. The 2011 GIC purportedly guaranteed monthly interest payments of 15% for two years.

4. In reality, Hunter did not make any investment with HSBC Bank Canada as he represented to Victim 1. Further, he fabricated what purported to be documentation of the 2010 and 2011 GICs to make Victim 1 believe that funds were invested as Hunter had represented. Instead, Hunter used Victim 1's funds to pay for various personal and business expenses.

5. Shortly after NBCI received the $150,000 from Victim 1 pursuant to the 2010 GIC, Hunter wired the funds into a SmartTradeFX account in the name of NBCI. ITA, another company controlled by Hunter, used the $150,000 obtained from Victim 1 to trade foreign currencies over the course of a year. Because ITA earned a commission of $50 for every trade it executed, ITA's trading strategy involved making a large number of trades, regardless of whether the trading resulted in a profit or loss for the account. As a result of these "commissions," ITA earned approximately $150,000, which Hunter transferred into bank accounts under his control. He then used the funds to: (i) pay personal and business expenses, (ii) make purported interest payments to Victim 1 on the 2010 GIC, and (iii) repay a personal loan that Victim 1 had made with Hunter.[1]

6. With respect to the $100,000 received from Victim 1 pursuant to the 2011 GIC, Hunter transferred the funds to a Scottrade account in the name of NBC. The funds were then withdrawn from the Scottrade account and deposited into a NBC bank account. Once in the NBC bank account, Hunter used those funds to pay for various personal and business expenses, including an office rental, an apartment rental, automobile payments, food, gasoline, utilities, airfare, hotels, clothing, gym memberships, personal grooming, and costs related to his children's schooling. Hunter also used the funds to pay $44,000 in personal loan repayments to Victim 1, and $6,250 in "interest" payments to Victim 1 pursuant to the 2010 and 2011 GICs. Hunter stopped making "interest" payments to Victim 1 pursuant to the 2010 and 2011 GICs in September 2011.

7. Similarly, in August 2010, Hunter recommended that a long-time, elderly client ("Victim 2"), make an investment in "US Bank." Hunter recommended Victim 2 make the investment outside of his account at HD Vest, and guaranteed that the investment would not lose any money. Based on Hunter's representations, Victim 2 signed a wire transfer form that authorized the transfer of $54,000 to "US Bank." The funds, however, were wired into a Scottrade account held in the name of NBC on August 13, 2010.

8. Hunter never invested Victim 2's $54,000 in US Bank. Nor were the funds used for any other investment. Instead, the funds were withdrawn from the Scottrade account and deposited into a NBC bank account. Over the course of six months, Hunter used the funds to pay personal and business expenses, including an office

1 Hunter obtained various personal loans from Victim 1 on at least three occasions in 2010 and 2011, borrowing a total of $175,000 from Victim 1. While Hunter has repaid Victim 1 on a $50,000 loan from early 2010, Hunter has yet to repay a $75,000 loan from February 2011 and a $50,000 loan from July 2011. Repayments on those loans stopped in September 2011.

rental, apartment rental, airline tickets, auto expenses, food, and over $33,000 in personal loan repayments to Victim 1. Victim 2 has never received any interest payments related to the "investment."

## D. VIOLATIONS

1. As a result of the conduct described above, Hunter willfully violated Sections 17(a)(1), (2), and (3) of the Securities Act, Section 10(b) of the Exchange Act, and Rules 10b-5(a), (b), and (c) thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

## III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 8A of the Securities Act and Section 21B of the Exchange Act;

C. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, whether Respondent should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act and Section 21B(a) of the Exchange Act, and whether Respondent should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act and Sections 21B(e) and 21C(e) of the Exchange Act.

## IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67637 / August 10, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14978**

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| **In the Matter of**<br><br>**Ameriwest Energy Corp.,**<br>**Clyvia, Inc., and**<br>**Crown Oil & Gas, Inc.,**<br><br>**Respondents.** | **ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934** |

**I.**

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the Respondents named in the caption.

**II.**

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Ameriwest Energy Corp. ("AWEC") [1] (CIK No. 1162200) is a revoked Nevada corporation located in Blaine, Washington with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). AWEC is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2008, which reported a net loss of $5,631,646 for the prior year. As of August 3, 2012, the common stock of AWEC was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Clyvia, Inc. ("CLYV") (CIK No. 1282549) is a revoked Nevada corporation located in Bellingham, Washington with a class of securities registered with the Commission

[1] The short form of each issuer's name is also its stock symbol.

pursuant to Exchange Act Section 12(g). CLYV is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended October 31, 2008, which reported a net loss of $1,005,820 for the prior nine months. As of August 3, 2013, the common stock of CLYV was quoted on OTC Link, had seven market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

3. Crown Oil & Gas, Inc. ("CWOI") (CIK No. 1388748) is a Nevada corporation located in Bellingham, Washington with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CWOI is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2009, which reported a net loss of $858,605 for the prior three months. As of August 3, 2013, the common stock of CWOI was quoted on OTC Link, had five market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

4. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

5. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

6. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

**III.**

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

## IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**
**August 10, 2012**

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|---|---|
| **In the Matter of**<br><br>**Ameriwest Energy Corp.,**<br>**Clyvia, Inc., and**<br>**Crown Oil & Gas, Inc.,**<br><br>**File No. 500-1** | **ORDER OF SUSPENSION OF TRADING** |

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Ameriwest Energy Corp. because it has not filed any periodic reports since the period ended December 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Clyvia, Inc. because it has not filed any periodic reports since the period ended October 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Crown Oil & Gas, Inc. because it has not filed any periodic reports since the period ended March 31, 2009.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on August 10, 2012, through 11:59 p.m. EDT on August 23, 2012.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67640 / August 10, 2012**

**INVESTMENT ADVISERS ACT OF 1940**
**Release No. 3443 / August 10, 2012**

**INVESTMENT COMPANY ACT OF 1940**
**Release No. 30165 / August 10, 2012**

**ACCOUNTING AND AUDITING ENFORCEMENT**
**Release No. 3400 / August 10, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14979**

**In the Matter of**

**PEAK WEALTH OPPORTUNITIES, LLC and DAVID W. DUBE, CPA,**

**Respondents.**

**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE AND NOTICE OF HEARING**

## I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act"), and Rule 102(e) of the Commission's Rules of Practice[1] against Peak Wealth Opportunities LLC ("Peak Wealth") and David W. Dube (collectively "Respondents").

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[1] Rule 102(e)(1)(iii) provides, in pertinent part, that:

## II.

After an investigation, the Division of Enforcement alleges that:

### A. RESPONDENTS

1. Peak Wealth, a Florida limited liability company located in Largo, Florida, has been registered with the Commission as an investment adviser since October 2007. From April 2008 to June 2010, Peak Wealth was the investment adviser to the StockCar Stocks Index Fund (the "Fund"), the sole series of the StockCar Stocks Mutual Fund, Inc. (the "Company"), formerly a registered investment company. Peak Wealth's basis for its registration with the Commission was its status as an investment adviser to an investment company registered under the Investment Company Act. Peak Wealth is a wholly owned subsidiary of Peak Capital Corporation ("Peak Capital"), which also owns Peak Securities Corporation, a former broker-dealer (which withdrew its broker-dealer registration in March 2010), and a publishing and debt collection business.

2. Dube, age 55, owns Peak Capital and its subsidiary businesses. He is the president and sole managing member of Peak Wealth. He was also the acting chief compliance officer of the Fund from October 2009 until June 2010. Dube is a certified public accountant licensed in Florida and New Hampshire. Dube registered with the Public Company Accounting Oversight Board in January 2010, indicating that he may conduct or play a substantial role in an audit in the future. A recent public company filing in September 2011 indicates that Dube has been engaged to prepare the company's audited financial statements. Other public filings from 2001 and 2002 indicate that Dube has also served on at least two public company audit committees. Dube has a disciplinary history with the Financial Industry Regulatory Authority in connection with his formerly registered broker dealer.

### B. RELEVANT ENTITY

The Company, now defunct, was a Maryland corporation that operated as an open-end diversified management investment company. The Company's sole series was the Fund. The Company was registered with the Commission from September 1998 until March 2011, when it formally deregistered.

### C. BACKGROUND

1. The Fund was an open-end management company that invested in companies of the StockCar Stocks Index (the "Index"), the Fund's proprietary index consisting of

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The Commission may deny, temporarily or permanently, the privilege of appearing or practicing before it to any person who is found...to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

approximately 40 companies that support NASCAR racing events. The Fund reported net assets of approximately $3.9 million in its most recently filed annual report for the fiscal year ended September 30, 2009.

2. Peak Wealth became the investment adviser to the Fund in April 2008, pursuant to a vote by the majority of the Company's shareholders approving Peak Wealth's written advisory agreement. The advisory agreement was for an initial term of two years and was subject to the Fund board's annual review and approval thereafter. Peak Wealth also served as the Fund's administrator pursuant to a separate administration agreement. The Fund was Peak Wealth's only client.

3. For its advisory services, Peak Wealth charged an annual fee of 0.65% of the Fund's average daily net assets. Peak Wealth contractually agreed to waive fees and/or reimburse the Fund for all expenses it incurred to the extent necessary to maintain the Fund's total operating expenses at 1.5% of the Fund's average daily net assets for a two-year period ending April 15, 2010. Throughout the period of the reimbursement agreement, the expenses paid by the Fund, exclusive of advisory fees, exceeded the 1.5% cap. Thus, due to the waiver agreement, Peak Wealth did not collect advisory fees while it served as adviser to the Fund.

## D. THE FUND BOARD'S TERMINATION OF PEAK WEALTH'S ADVISORY CONTRACT

1. In late 2008, the Fund's board began to raise concerns about Peak Wealth's ability to meet its expense reimbursement obligation to the Fund. Peak Wealth had failed to reimburse the Fund for expenses it owed under the advisory agreement, which resulted in the Fund delaying the filing of its annual report for the fiscal year ended September 30, 2008.

2. By September 2009, the Fund had accumulated another receivable for expenses owed from Peak Wealth of approximately $50,000. Dube repeatedly promised the board that he would repay the Fund, but he never did. The Fund's auditor refused to release its audit opinion without repayment of the outstanding obligation, resulting in the Fund delaying the filing of its 2009 annual report. Ultimately, the board liquidated Dube's personal holdings in the Fund in order to satisfy the outstanding receivable.

3. The Fund's portfolio manager, who worked for Peak Wealth and handled the trading activity and index rebalancing for the Fund, also encountered problems with Peak Wealth and Dube. Dube failed to respond to multiple letters and emails from the portfolio manager throughout 2008 and 2009 regarding the Fund's compliance obligations, the portfolio manager's concerns about the regularity and substance of his communications with Peak Wealth and Dube, and his compensation. The portfolio manager ultimately raised his concerns about the lack of communication with the Fund's board in late 2009.

4. In March 2010, prior to the conclusion of Peak Wealth's initial two year investment advisory agreement with the Fund, the Fund's board requested documents from Peak Wealth and Dube in connection with its first annual review of Peak Wealth's investment advisory

contract under Section 15(c) of the Investment Company Act. The board sent a second request in May 2010. Peak Wealth requested an extension of time to respond to the board's requests but failed to provide the board with any of the requested documents.

5. In June 2010, the board terminated Peak Wealth's advisory agreement, and voted to liquidate the Fund's assets (approximately $4 million) and to deregister the Company.

6. The Fund has distributed to investors all remaining assets net of liquidation expenses. On March 23, 2011, the Division of Investment Management, pursuant to delegated authority, issued an order terminating the Company's registration under the Investment Company Act.

E. SEC EXAMINATION OF PEAK WEALTH

1. In April 2010, SEC examination staff from the Miami Regional Office initiated an examination of Peak Wealth and the Fund. The examination staff faxed its initial document request list to Peak Wealth and the Fund on April 7, 2010, one week before it commenced its examination. When the staff arrived on April 14, Dube did not have any documents for Peak Wealth or the Fund. Dube repeatedly assured examiners that responsive documents would be forthcoming.

2. The examination staff provided Peak Wealth with seven additional requests for documents. These included requests for financial records relating to Peak Wealth's advisory business including: Peak Wealth's balance sheet, trial balance, income statement, cash flow statements, and cash receipts and disbursements journals.

3. Dube and Peak Wealth did not produce these financial records because they did not exist. Instead, Dube told examiners that he would create the requested financial records relating to Peak Wealth.

4. The examination staff also provided a document request to Dube (in his capacity as a representative of Peak Wealth and the Fund's acting chief compliance officer) for documents relating to the maintenance of the Index, including the list of eligible issuers and proof of their eligibility, and records of daily value computations, the weighting of positions, the annual rebalancing process, and the correlation between the performance of the Fund and the Index.

5. At the conclusion of the field work, the majority of the requests for Peak Wealth's financial records remained outstanding, as well as requests relating to the maintenance of the Index. Examination staff referred the matter to the Division of Enforcement for further review.

6. The Company, the Fund (through its board), and the former portfolio manager subsequently produced documents in response to a subpoena from the enforcement staff. However, Peak Wealth and Dube never responded to the staff's document subpoenas, and Dube failed to appear for investigative testimony pursuant to a subpoena.

F. PEAK WEALTH'S FILINGS

Although the Fund terminated Peak Wealth's advisory agreement in June 2010, Peak Wealth continues to be registered with the Commission. Peak Wealth has not filed a Form ADV since September 2008. Peak Wealth's September 2008 Form ADV states that its basis for registration with the Commission is its status as an investment adviser to a registered investment company. Peak Wealth has not filed a Form ADV-W or annually amended Forms ADV for its fiscal years ended September 30, 2009, 2010, and 2011.

G. VIOLATIONS

1. As a result of the conduct described above, Peak Wealth willfully violated Section 15(c) of the Investment Company Act which requires, among other things, that the terms of any contract or agreement, whereby a person undertakes regularly to serve or act as investment adviser of a registered investment company, and any renewal thereof, be approved by a vote of the majority of a fund's disinterested directors or trustees at a meeting called for the purpose of voting on such approval. Section 15(c) makes it the duty of an investment adviser of a registered investment company to furnish such information as may reasonably be necessary for fund directors to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company.[2] Peak Wealth failed to provide the Fund's board with information necessary for the board to evaluate the nature, quality, and cost of its services in connection with the board's first annual renewal of Peak Wealth's advisory agreement. Dube willfully aided and abetted and caused Peak Wealth's violations of Section 15(c) of the Investment Company Act.

2. As a result of the conduct described above, Peak Wealth willfully violated Section 204 of the Advisers Act and Rules 204-1(a)(1) and 204-2(a)(1), (2), (4), (5), and (6) thereunder. Section 204 of the Advisers Act requires investment advisers to make and keep certain records and furnish copies thereof, and to make and disseminate such reports as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. Section 204 specifies that all records of investment advisers are subject to examination by representatives of the Commission. Rule 204-2 provides that investment advisers registered or required to be registered shall make and keep true, accurate and current copies of various specific categories of books and records, including:

- A journal or journals, including cash receipts and disbursements, records, and any other records of original entry forming the basis of entries in any ledger;

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[2] See In the Matter of Morgan Stanley Investment Management, Inc., Advisers Act Release No. 3315 (Nov. 16, 2011)(charging adviser with 15(c) violations for failing to provide board with information relating to sub-advisory services); In the Matter of New York Life Investment Management, LLC, Advisers Act Release No. 2883 (May 27, 2009)(charging adviser with 15(c) violations for failing to provide board with information reasonably necessary to evaluate fund's profitability) .

- General and auxiliary ledgers (or other comparable records) reflecting asset, liability, reserve, capital, income and expense accounts;
- All check books, bank statements, cancelled checks and cash reconciliations of the investment adviser;
- All bills or statements (or copies thereof), paid or unpaid, relating to the business of the investment adviser as such; and
- All trial balances, financial statements, and internal audit working papers relating to the business of such investment adviser.

Rule 204-1(a)(1) requires registered investment advisers to file with the Commission annual amended Forms ADV within 90 days of their fiscal year end. Peak Wealth failed to make, keep, and furnish true, accurate and current books and records. Peak Wealth failed to make and keep financial statements, bank records, cash receipts or disbursement records, general or auxiliary ledgers, trial balances, or income and expense statements for its advisory business. Peak Wealth offered to create certain financial statements for the examination staff, but only after the fact, and never actually produced them. Peak Wealth also failed to furnish certain records to the examination and enforcement staff relating to the maintenance of the Index. The enforcement staff was compelled to subpoena these documents directly from a portfolio manager who worked for Peak Wealth. Further, Peak Wealth failed to file annual amended Forms ADV for its fiscal years 2009, 2010, and 2011. Dube willfully aided and abetted and caused Peak Wealth's violations of Section 204 of the Advisers Act and Rules 204-1(a)(1) and 204-2(a)(1), (2), (4), (5), and (6) thereunder.

3. As a result of the conduct described above, Peak Wealth willfully violated Section 203A of the Advisers Act and Rule 203A-1(b)(2) thereunder. Section 203A of the Advisers Act generally prohibits investment advisers with assets under management of less than $25 million from registering with the Commission, unless the adviser is an investment adviser to a registered investment company, or comes within one of the specified exemptions.[3] Advisers Act Rule 203A-1(b)(2) requires a registered investment adviser who becomes ineligible for SEC registration to file Form ADV-W to withdraw its SEC registration within 180 days of its fiscal year end. Peak Wealth failed to timely file a Form ADV-W after it became ineligible for SEC registration because the Fund terminated its advisory agreement on June 1, 2010. Peak Wealth should have filed its Form ADV-W within 180 days of September 30, 2010, its 2010 fiscal year end. Dube willfully aided and abetted and caused Peak Wealth's violations of Section 203A of the Advisers Act and Rule 203A-1(b)(2) thereunder.

[3] Effective July 21, 2011, Section 203A generally prohibits an adviser that has assets under management between $25 million and $100 million from registering with the Commission, unless it is an investment adviser to a registered investment company, or it comes within one of the specified exemptions. *See* Advisers Act Section 203A(a)(2) (amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010)); *Final Rule: Rules Implementing Amendments to the Investment Advisers Act of 1940,* Investment Advisers Act Release No. 3221 (June 22, 2011).

## III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Sections 203(e) and 203(f) of the Advisers Act including, but not limited to, civil penalties pursuant to Section 203 of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, civil penalties pursuant to Section 9 of the Investment Company Act;

E. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b)(6) of the Exchange Act;

F. What, if any, remedial action is appropriate in the public interest against Dube pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice; and

G. Whether, pursuant to Section 203(k) of the Advisers Act, and Section 9(f) of the Investment Company Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 203A and 204 of the Advisers Act and Rules 203A-1(b)(2), 204-1(a)(1), 204-2(a)(1), (2), (4), (5) and (6) thereunder, and Section 15(c) of the Investment Company Act, and whether Respondents should be ordered to pay civil penalties pursuant to Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act.

## IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as

provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 240**

**Release No. 34-67405A; File No. S7-30-11**

**RIN 3235-AL19**

**Extension of Interim Final Temporary Rule on Retail Foreign Exchange Transactions**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Interim final temporary rule; extension; request for comment.

**SUMMARY:** The Securities and Exchange Commission ("Commission") is amending interim final temporary Rule 15b12-1T under the Securities Exchange Act of 1934 ("Exchange Act") to extend the date on which the rule will expire from July 16, 2012 to July 16, 2013.

**DATES:** *Effective Date*: July 16, 2012. The expiration date of interim final temporary Rule 15b12-1T (17 CFR 240.15b12-1T) is extended to July 16, 2013.

*Comment Date:* Comments on the interim final temporary rule should be received on or before October 31, 2012.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/interim-final-temp.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-30-11 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Elizabeth Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number S7-30-11. This file number should be included on the subject line if e-mail is used. To help the Commission to process and review your comments more efficiently, please use only one method. The Commission will post all comments on its website: (http://www.sec.gov/rules/interim-final-temp.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Joanne Rutkowski, Branch Chief, Bonnie Gauch, Senior Special Counsel, and Leila Bham, Special Counsel, Division of Trading and Markets, at (202) 551-5550, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

**SUPPLEMENTARY INFORMATION**: The Commission is extending the expiration date for Rule 15b12-1T under the Exchange Act.

## I. DISCUSSION

Section 742 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[1] amended the Commodity Exchange Act ("CEA") to provide that a person

1 Public Law 111–203, 124 Stat. 1376 (2010).

for which there is a Federal regulatory agency,[2] including a broker or dealer ("broker-dealer") registered under section 15(b) (except pursuant to paragraph (11) thereof) or 15C of the Exchange Act,[3] shall not enter into, or offer to enter into, a foreign exchange ("forex") transaction[4] with a person who is not an "eligible contract participant"[5] ("ECP") except pursuant to a rule or regulation of a Federal regulatory agency allowing the transaction under such terms and conditions as the Federal regulatory agency shall prescribe ("retail forex rule").[6] A Federal

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2 7 U.S.C. 2(c)(2)(E)(i), as amended by § 742(c) of the Dodd-Frank Act, defines a "Federal regulatory agency" to mean the Commodity Futures Trading Commission ("CFTC"), the Securities and Exchange Commission, an appropriate Federal banking agency, the National Credit Union Association, and the Farm Credit Administration.

3 7 U.S.C. 2(c)(2)(B)(i)(II).

4 7 U.S.C. 2(c)(2)(B)(i)(I). Transactions described in CEA section 2(c)(2)(B)(i)(I) include "an agreement, contract, or transaction in foreign currency that . . . is a contract of sale of a commodity for future delivery (or an option on such a contract) or an option (other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a))."

5 Section 1a(18) of the CEA defines "eligible contract participant" generally to mean certain regulated persons; entities that meet a specified total asset test (*e.g.*, a corporation, partnership, proprietorship, organization, trust, or other entity with total assets exceeding $10 million) or an alternative monetary test coupled with a non-monetary component (*e.g.*, an entity with a net worth in excess of $1 million and engaging in business-related hedging; or certain employee benefit plans, the investment decisions of which are made by one of four enumerated types of regulated entities); and certain governmental entities and individuals that meet defined thresholds. 7 U.S.C. 2(c)(2)(E)(i). The CFTC has adopted rules further clarifying the definition of "eligible contract participant" in the CEA. *See* 17 CFR 1.3(m). *See also Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"* Exchange Act Release No. 66868 (April 27, 2012), 77 FR 30596 (May 23, 2012). Because transactions that are the subject of this release are commonly referred to as "retail forex transactions," this release uses the term "retail customer" to describe persons who are not ECPs.

6 *See* 7 U.S.C. 2(c)(2)(B)(i)(II) and 7 U.S.C. 2(c)(2)(E)(ii)(I). On September 10, 2010, the CFTC adopted a retail forex rule for persons subject to its jurisdiction. *See Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries,* 75 FR 55410 (September 10, 2010). The CFTC had proposed its rules regarding retail forex transactions prior to the enactment of the Dodd-Frank Act. *See Regulation of Off-*

regulatory agency's retail forex rule must treat all forex agreements, contracts, and transactions and their functional or economic equivalents, similarly.[7] Any retail forex rule also must prescribe appropriate requirements with respect to disclosure, recordkeeping, capital and margin, reporting, business conduct, and documentation, and may include such other standards or requirements as the Federal regulatory agency determines to be necessary.[8]

The prohibition in CEA section 2(c)(2)(B) took effect on July 16, 2011. Beginning on that date, broker-dealers, including broker-dealers also registered with the CFTC as futures commission merchants ("BD-FCMs"), for which the Commission is the "Federal regulatory agency," were no longer able to engage in off-exchange retail forex futures and options transactions with a customer except pursuant to a retail forex rule issued by the Commission.[9] On July 13, 2011, the Commission adopted interim final temporary Rule 15b12-1T, which temporarily permits a broker-dealer to engage in a "retail forex business," as defined in the rule, in compliance with the Exchange Act, the rules and regulations thereunder, and the rules of the self-regulatory organizations of which the broker-dealer is a member, insofar as they are

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*Exchange Retail Foreign Exchange Transactions and Intermediaries*, 75 FR 3282 (January 20, 2010). The Federal Deposit Insurance Corporation ("FDIC") and the Office of the Comptroller of the Currency ("OCC") have adopted similar rules. *See Retail Foreign Exchange Transactions*, 76 FR 40779 (July 12, 2011); *Retail Foreign Exchange Transactions*, 76 FR 41375 (July 14, 2011). The Board of Governors of the Federal Reserve System (the "Board") has proposed rules for bank holding companies. *See Retail Foreign Exchange Transactions*, 76 FR 46652 (August 3, 2011).

7 7 U.S.C. 2(c)(2)(E)(iii)(II).

8 7 U.S.C. 2(c)(2)(E)(iii)(I).

9 *See* 7 U.S.C. 2(c)(2)(B)(i)(II)(cc) (giving the CFTC jurisdiction over retail forex transactions with FCMs that, among other things, are not registered broker-dealers) and 7 U.S.C. 2(c)(2)(C)(i)(I)(aa). In addition, a commenter noted that the CFTC "does not have jurisdiction over retail foreign exchange activities conducted by broker-dealers, including entities that are dually registered as broker-dealers with the SEC and as futures commission merchants ('FCMs') with the CFTC." SIFMA/ISDA Letter at 1.

applicable to retail forex transactions.[10] We explained at the time that our action was intended to preserve potentially beneficial market practices that, for example, may serve to minimize a retail customer's exposure to the risk of changes in foreign currency rates in connection with the customer's purchase or sale of a security. We also discussed in the Interim Release that there may be potentially abusive practices such as lack of disclosure about fees and forex pricing, and insufficient capital or margin requirements occurring in the retail forex market, and sought comment on these practices and steps we should take to seek to prevent them.[11] Rule 15b12-1T, by its terms and without further Commission action, would have expired on July 16, 2012.

The Commission received comments on the Interim Release, which are summarized below.[12]

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10 *See Retail Foreign Exchange Transactions*, Exchange Act Release No. 64874 (July 13, 2011), 76 FR 41676 (July 15, 2011) (adopting 17 CFR 240.15b12-1T) ("Interim Release").

11 Our Office of Investor Education Advocacy has published an Investor Bulletin providing information about retail forex investing, including information about the risks involved in that trading. *See Investor Bulletin: Foreign Currency Exchange (Forex) Trading for Individual Investors* (July 2011), available at http://www.sec.gov/investor/alerts/forextrading.pdf. The CFTC and the North American Securities Administrators Association also have published an alert regarding risks of fraud in forex markets. *See Foreign Exchange Currency Fraud: CFTC/NASAA Investor Alert*, available at http://www.cftc.gov/ConsumerProtection/FraudAwarenessPrevention/ForeignCurrencyTrading/cftcnasaaforexalert. We recently brought an enforcement action against the CEO of a purported foreign currency trading firm alleging fraud by that person. *See SEC v. Jeffery A. Lowrance, et al.*, Case No. CV-11-3451, press release, complaint and litigation release, available at http://www.sec.gov/news/press/2011/2011-147.htm.

12 The comments are available at http://www.sec.gov/comments/s7-30-11/s73011.shtml. In addition to other specific requests for comment, the Commission requested comment in the Interim Release as to whether Rule 15b12-1T should be extended, and if so for how long.

- Nine commenters asked the Commission to preserve their ability to engage in retail forex transactions.[13]
- One commenter stated that the Commission should rescind the rule and allow the ban to take effect or, in the alternative, to limit the scope of the rule to a narrowly defined class of forex transactions, specifically hedging and the facilitation of settlement of foreign securities.[14] The commenter further stated that in adopting Rule 15b12-1T, the Commission did not provide notice of and opportunity for comment on the rule, and did not include a "concrete assessment or quantification of the need" for the relief granted by this rule.
- Another commenter provided data on the returns of retail forex accounts at futures commission merchants and retail foreign exchange dealers, and offered recommendations that the commenter believed would improve retail forex transactions and identified areas of retail forex that the commenter believed warrants further study.[15] This commenter also

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13 *See* email comments from Raul Gonzalez, dated July 17, 2011, James Peck, dated July 17, 2011, Bob Flowers, dated July 17, 2011, James M. Beatty, dated July 17, 2011, Angela Li, dated July 17, 2011, Mark A. McDonnell, dated July 21, 2011, Mark Smith, dated July 23, 2011, John Baur, dated July 27, 2011, and Ronald Covington, dated October 23, 2011.

14 *See* Letter from Dennis M. Kelleher, President and CEO, and Stephen W. Hall, Securities Specialist, Better Markets, Inc. to Ms. Elizabeth Murphy, Secretary, Commission, dated September 12, 2011 ("Better Markets Letter"). We understand the commenter's reference to transactions entered into to facilitate the settlement of foreign securities to mean the conversion trades discussed *infra*, in the text accompanying notes 19 and 20.

15 Letter from Justin Hughes, CFA and Managing Member, Philadelphia Financial Management of San Francisco to Ms. Elizabeth Murphy, Secretary, Commission, dated August 2, 2011 ("Philadelphia Financial Letter"). *See also* letter from P. Georgia Bullitt, Michael A. Piracci and F. Mindy Lo, Morgan Lewis to Joseph Furey, Bonnie L. Gauch and Adam Yonce, Commission, dated July 28, 2011 ("Morgan Lewis Letter").

suggested that currency exchange-traded funds ("currency ETFs") would provide an alternative means for effectively hedging against currency risk.[16]

- One commenter provided data from five large broker-dealers showing that the notional amount of foreign exchange conversion trades at those broker-dealers accounts for approximately 90% of those firms' foreign exchange transactions. The firms' data further indicated that 99% of customer accounts have entered into a conversion trade, though not all trades within an account may be conversion trades.[17]
- One group of commenters urged the Commission to adopt a final rule based on the approach followed in the interim final temporary rule, with certain modifications.[18] These commenters maintained that it is in the best interests of retail customers to have the opportunity to conduct forex activity as part of their broader investing activity, through their broker-dealers, with the assistance of personnel who have expertise in forex.

More recently, in April 2012, a group of commenters asked the CFTC, as well as other Federal regulatory agencies (including the Commission), to take the view that forex transactions that are solely incidental to, and that are initiated for the sole purpose of, permitting a customer to complete a transaction in a foreign security, so-called "conversion trades," are not prohibited

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16 *See* Philadelphia Financial Letter. *See also* Better Markets Letter. While certain forex transactions, in particular portfolio hedges or currency transactions that are part of a diversified investment strategy, may have close substitutes in currency ETFs, currency conversions that facilitate securities transactions (discussed in more detail below) may not have such close substitutes.

17 *See* Morgan Lewis Letter.

18 *See* Letter from Kenneth E. Bentsen, Jr., Executive Vice President Public Policy and Advocacy, SIFMA and Robert Pickel, Executive Vice Chairman, ISDA, to Ms. Elizabeth Murphy, Secretary, Commission, dated October 17, 2011 ("SIFMA/ISDA Letter"). *See also* Memorandum from SIFMA and ISDA to Marc Menchel, Gary Goldsholle, Matthew Vitek, Rudy Verra, Glen Garofalo, FINRA, dated February 23, 2012.

retail forex transactions for purposes of section 2 of the CEA.[19] These commenters maintain that Congress did not intend to include within the scope of the CEA section 2 prohibition currency transactions effected in connection with securities transactions, stating that "[s]uch transactions do not involve speculation in the underlying currencies and, to the contrary, will result in an exchange of currencies to be used to settle the relevant securities transactions."[20] We anticipate that the interpretation will be addressed in the context of the CFTC's and SEC's joint rulemaking to further define terms such as "swap" and "security-based swap" under Title VII of the Dodd-Frank Act ("Products Definition Release").[21] We further anticipate that the rulemaking will be finalized in the near future and the CFTC will provide at that time its views of whether conversion trades are excluded from the prohibition under CEA section 2.

The ABA/GFMA Letter and the CFTC response affect the scope, substance, and timing of our consideration of further rulemaking for retail forex transactions. If the CFTC were to adopt the interpretation put forth by the ABA/GFMA, conversion trades, which commenters have asserted comprise the overwhelming majority of retail forex transactions conducted through broker-dealers,[22] would not fall within the scope of the prohibition. The potential for such

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19 *See* Letter from Phoebe A. Papageorgiou, Senior Counsel, American Bankers Association, and James Kemp, Managing Director, Global Foreign Exchange Division, to Thomas J. Curry, Comptroller, OCC, Robert E. Feldman, Executive Secretary, FDIC, Jennifer J. Johnson, Secretary, the Board, David Stanwick, Secretary, CFTC, and Elizabeth Murphy, Secretary, Commission, dated April 18, 2012 ("ABA/GFMA Letter").

20 *Id.* at 2.

21 *See also Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping,* Securities Act Release No. 9204 (April 29, 2011), 76 FR 29818 (May 23, 2011) (proposing release).

22 *See* Morgan Lewis Letter.

interpretation means that further rulemaking could well confront a very different set of transactions than contemplated in April 2012, one focused not on conversion trades, but rather on apparently less common and more diverse retail forex transactions identified by commenters, such as hedging transactions and direct investments.[23] It also means that further rulemaking would need to consider whether there are classes of conversion trades not excluded under any final interpretation that may be adopted by the CFTC that must be addressed separately. We expect to consider these types of transactions and an appropriate regulatory approach to them in considering whether and what permanent rules we should adopt in this area.

Extending the expiration of Rule 15b12-1T to July 16, 2013 will provide the Commission additional time to consider carefully these issues. The extension will help to ensure that we have sufficient time to take such action as we may determine appropriate in this area, particularly in light of the diverse classes of transactions – beyond the conversion trades that have been the focus of comments to date – that any further rulemaking may need to consider.[24] We recognize that commenters' views differed as to whether and to what extent we should permit broker-dealers to continue to engage in some or all retail forex transactions. As discussed above, some commenters urged us to permit the statutory prohibition simply to take effect, thereby preventing potential abuses of retail customers by broker-dealers and BD-FCMs. A number of retail customers asked us to permit them to have continued access to retail forex transactions through broker-dealers. Some commenters stated that we should make certain revisions to Rule 15b12-

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23 *See* SIFMA/ISDA Letter (Annex A, Part I).

24 If the Commission adopts permanent rules for retail forex transactions by broker-dealers before July 16, 2013, the Commission will consider whether it is appropriate to terminate the effectiveness of Rule 15b12-1T as part of that rulemaking.

1T, while others favored the rule as written, stating that existing broker-dealer regulations adequately address retail forex activities.

In considering commenters' views, we believe, on balance, that we should extend the expiration date of the rule to permit further assessment by the Commission in this area, which would be informed by any potential CFTC interpretation regarding conversion trades. Our view is influenced by investors' views that we should permit them to conduct retail forex transactions with broker-dealers. We also are mindful that while futures commission merchants that are not also broker-dealers could continue to engage in retail forex transactions in compliance with CFTC rules, a futures commission merchant that is also a broker-dealer would be prohibited from engaging in retail forex transactions if we do not extend Rule 15b12-1T. For these reasons, we are extending the expiration date of Rule 15b12-1T to July 16, 2013 to prevent retail customers who transact retail forex transactions through a broker-dealer from being potentially disadvantaged by the prohibition for retail forex transactions taking effect.[25] Given the limited nature of this extension, the pending request for a CFTC interpretation regarding conversion trades, the need to further understand the implications of the CFTC's interpretation, and the scope of comments we are seeking before any further action is taken, we are not modifying the interim final temporary rule other than to extend the expiration date of Rule 15b12-1T to July 16, 2013. Absent further action by the Commission, Rule 15b12-1T as amended will expire on July 16, 2013 at 11:59 p.m. Eastern Time.

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25 While retail customers could of course open an account with a futures commission merchant (that is not also registered as a broker-dealer) to engage in retail forex transactions, as explained below, this could create certain inefficiencies and additional costs. *See* discussion in the Economic Analysis section below.

## II. REQUEST FOR COMMENT

The Commission requests comment regarding all aspects of the interim final temporary rule and the current market practices involving retail forex transactions, as well as any investor protection or other concerns that commenters believe should be addressed by Commission rulemaking. The Commission particularly requests comment from broker-dealers, including BD-FCMs, that are currently engaged or plan to engage in a retail forex business, retail customers that engage in forex transactions, and ECPs. The Commission welcomes information from all affected parties about the current scope and nature of retail forex transactions. This information, together with input from market participants and other regulators, as well as comments received on the Interim Release, will help inform the Commission's consideration of the appropriate regulatory framework, if any, for retail forex transactions before or beyond the expiration of the interim final temporary rule.

The Commission seeks comment on the need for further Commission rulemaking, should the CFTC determine that certain conversion trades are not subject to the CEA prohibition with respect to retail forex transactions.[26] We specifically seek to better understand the other types of retail forex transactions in which broker-dealers may engage, such as forex transactions to hedge portfolio currency risk or to diversify a portfolio, that would not be excluded from the prohibition under section 2 of the CEA by the requested interpretation. We also request information about what mechanisms broker-dealers use currently to comply with existing disclosure, recordkeeping, capital and margin, reporting, business conduct and documentation rules with respect to each type of retail forex transaction in which they engage. What policies and procedures and supervisory controls, for example, have broker-dealers implemented to

[26] *See* 7 U.S.C. 2(c)(2)(E)(ii)(I).

address those transactions? We also seek comment on what mechanisms broker-dealers use currently to comply with other existing regulatory requirements with respect to retail forex transactions.

If commenters believe further rulemaking is needed, please explain why, and provide us with a discussion of the types of transactions for which rules are needed and the circumstances under which such transactions are entered into. If commenters believe further rulemaking is not needed, please explain why not. The Commission seeks comment on the extent to which broker-dealers' retail forex activities may be affected, and any impact on retail customers of broker-dealers, in the event the Commission does not adopt any further rules in this area.

The Commission also seeks comment on the retail forex activities of BD-FCMs, and whether the Commission should adopt tailored rules for these intermediaries. We seek comment on the nature of BD-FCM retail forex activities, including the type of transactions in which they engage, and which part of the dually registered entity may engage in these activities or transactions. We also request comment on the mechanisms BD-FCMs use currently to comply with existing disclosure, recordkeeping, capital and margin, reporting, business conduct and documentation rules with respect to each type of retail forex transaction in which they engage. In connection with this specific request for comment, please identify whether the relevant requirements are Exchange Act Rules, CEA Rules, or rules of a particular self-regulatory organization ("SRO") of which the BD-FCM is a member. The Commission also seeks comment on the extent to which the retail forex activities of BD-FCMs may be affected, and any impact on retail customers of BD-FCMs, in the event the Commission does not adopt any further rules in this area.

Some commenters have suggested that if broker-dealers were prohibited from engaging in retail forex activities, currency ETFs would be a reasonable substitute for broker-dealer customers seeking to hedge their currency exposures.[27] The Commission requests comment on whether and how currency ETFs could meet the needs of retail customers in this regard. The Commission also requests information about how currency ETFs (and any other financial product or service that commenters believe could serve as a substitute for forex) could be used more generally to meet the risk mitigation and any other needs of retail customers that currently are addressed using retail forex transactions. Would currency ETFs (or other financial products) hedge currency risks in connection with foreign securities transactions in the same manner or differently than retail forex transactions? How would the transaction and other costs associated with currency ETFs and retail forex transactions compare? We further seek comment on what the associated benefits and costs would be of retail customers using currency ETFs or some other product or service, as a substitute for retail forex. We also seek comment on the liquidity of such alternative products or services, the ease or difficulty of accessing and using those products or services, and any additional risks involved in using those products or services.

The Commission also seeks comment on whether Rule 15b12-1T should be extended beyond July 16, 2013, and if so, why and for how long, or whether it should be adopted as a final rule.

## III. ECONOMIC ANALYSIS

### A. Introduction

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking under the Exchange Act and is required to consider or determine whether an action is

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27 *See* Philadelphia Financial Letter at 8, and Better Markets Letter at 3.

necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition and capital formation.[28] In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.[29] Section 23(a)(2) of the Exchange Act prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[30]

We understand that under the current regulatory regime, retail customers typically enter into foreign exchange transactions with broker-dealers for a number of reasons. Industry participants have told us that the most common transaction is a foreign exchange conversion trade, in which a currency trade is made in connection with a foreign securities transaction.[31] Commenters have also told us that retail customers enter into forex transactions with broker-dealers as part of a hedging strategy. For instance, retail customers may engage in forex transactions through broker-dealers in order to hedge currency risk in securities or in a portfolio generally held in the customer's brokerage account; they may also engage in these transactions in order to obtain exposure to foreign markets as part of their investment strategy.[32]

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28 *See* 15 U.S.C. 78c(f).

29 *See* 15 U.S.C. 78w(a)(2).

30 *See id.*

31 Morgan Lewis Letter. As explained above, the ABA/GFMA Letter requests an interpretation that would exclude conversion trades from the prohibition under CEA section 2.

32 SIFMA/ISDA Letter at 4, Annex A at 1 – 2.

Congress prohibited the retail forex transactions described in CEA section 2 except pursuant to rules adopted by the relevant Federal regulatory agencies allowing the transactions. As we noted in the Interim Release, some of these transactions, in particular hedging transactions and securities conversion trades, may be beneficial to investors.[33] At the same time, as discussed in the Interim Release, the Commission is aware of potentially abusive practices that may be occurring in the retail forex market. Such practices may include, for example, lack of disclosure about fees and forex pricing, and insufficient capital or margin requirements.[34]

As discussed above, on April 18, 2012, a group of commenters asked the CFTC, as well as other Federal regulatory agencies (including the Commission), to take the view that forex transactions that are solely incidental to, and are initiated for the sole purpose of, permitting a client to complete a transaction in a foreign security, through "conversion trades," would not be subject to the retail forex prohibition under section 2 of the CEA.[35] An interpretation by the CFTC that conversion trades are not subject to the statutory prohibition could significantly affect the costs and benefits of any action by the Commission with regard to retail forex transactions going forward. Commenters have stated that conversion trades comprise the vast majority of retail forex transactions engaged in by broker-dealers,[36] but also note that there are other types of forex transactions in which broker-dealers engage with retail customers.[37] Because the request for the interpretation is still pending, however, the Commission will continue to consider

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33 *See* Interim Release at 41684.

34 *See id.*

35 *See* ABA/GFMA Letter.

36 *See* Morgan Lewis Letter.

37 *See* SIFMA/ISDA Letter, Annex A.

conversion trades as retail forex transactions that would be prohibited but for Rule 15b12-1T, for purposes of our economic analysis.

Extending Rule 15b12-1T maintains the regulatory framework that currently exists for broker-dealers, and does not create any new regulatory obligations. Furthermore, the rule preserves the ability of broker-dealers to provide, among other services, hedging and conversion trades to retail customers while the Commission considers what further appropriate steps to take, if any. [38]

The Commission has previously considered and discussed in the Interim Release its economic analysis of Rule 15b12-1T.[39] The Commission solicited comment on its economic analysis in the Interim Release, and received one comment that addressed but did not support its economic analysis.[40] As stated in the Interim Release, we adopted Rule 15b12-1T as an interim final temporary rule to allow the existing regulatory framework for retail forex transactions to continue for a defined period, to avoid potentially unintended consequences from broker-dealers immediately discontinuing their retail forex business, and to provide the Commission sufficient time to determine the appropriate regulatory framework regarding retail forex transactions.[41] Furthermore, investors who commented on the rule asked the Commission to preserve their

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38 To the extent that conversion trades are not excluded from the prohibition in CEA section 2, extension of the Rule 15b12-1T would also have the benefit of allowing customers to continue to engage in those transactions as part of their brokerage activities while the Commission considers any further action.

39 For a detailed description of the costs and benefits of Rule 15b12-1T, *see also* Interim Release at 41684.

40 Better Markets Letter. *But see* SIFMA/ISDA Letter.

41 *See* Interim Release at 48683.

ability to engage in retail forex transaction through their broker-dealers. In addition, we included an economic analysis of the rule in the Interim Release.[42]

As mentioned above, based on data a commenter provided of five broker-dealers, in terms of notional amount, foreign exchange conversion trades would account for approximately 90% of foreign exchange transactions done through broker-dealers, and 99% of all broker-dealer customer accounts are involved in conversion trades, though not all trades within an account may be conversions.[43] Commenters have told us that certain forex transactions, particularly certain portfolio hedges, may have close substitutes in currency ETFs.[44] It does not appear that currency ETFs would necessarily function as effectively in mitigating the currency risk of particular securities transactions, because the precise timing and amount of a securities transaction may not be readily matched to a currency ETF, as conversion trades are customer-specific and typically designed to facilitate particular securities transactions, whereas currency ETFs generally are designed to provide broad exposure to exchange rate movements. The contracts used to complete forex conversions do have close substitutes in exchange-traded currency futures, as both involve the exchange of currency at a future date. However, as with currency ETFs, the precise timing and amount of a securities transaction may not be easily matched to exchange-traded futures contracts, which have standardized maturity dates and notional amounts. Off-exchange forwards, on the other hand, can be easily customized to match a particular transaction. Additionally, exchange-traded futures are not as effective at mitigating risks between the trade

42 *See id.* at 41684.

43 Morgan Lewis Letter.

44 *See* Philadelphia Financial Letter. *See also* Better Markets Letter.

and settlement dates, since mark-to-market margin requirements expose the investor to additional cash flow risk.

The Commission understands that conversion trades can be replicated at futures commission merchants. However, as a practical matter, this would require the customer to maintain multiple accounts, which could increase transaction costs and reduce efficiency relative to conversion trades performed within a broker-dealer.

### B. Alternatives Considered

The Commission considered certain alternatives to extending Rule 15b12-1T. One alternative would be to let Rule 15b12-1T expire on its original expiration date, and so preclude broker-dealers from engaging in certain types of retail forex business other than, potentially, conversion trades, at least until such time as the Commission were to adopt final rules in this area. The benefit of this alternative would be that the abuses Congress sought to address through Dodd-Frank Act Section 724 would be addressed through this complete prohibition. The cost of this alternative would be that an outright prohibition on retail forex activity would interfere with certain business activities engaged in by broker-dealers that are potentially beneficial for their customers, in particular the potential benefit to customers relating to conversion trades. We note in this alternative approach, retail customers of broker-dealers would be required to open an account with a futures commission merchant or other financial service provider merely to engage in currency transactions intended to mitigate risks in connection with brokerage transactions in foreign securities. While this shifting to services to another intermediary would impose additional costs, retail customers may, however, benefit from the protection of rules to which those intermediaries are subject.[45]

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[45] *See supra* note 6.

The Commission has not adopted this alternative at this time for the reasons discussed above, and in particular because of concerns that we not disrupt potentially beneficial market practices, such as conversion trades that may serve to minimize a retail customer's exposure to the risk of changes in foreign currency rates in connection with the customer's purchase or sale of a security. In addition, we have not adopted this alternative because the CFTC's interpretation regarding conversion trades is not yet settled.

The Commission also considered adopting Rule 15b12-1T as a final, permanent rule. While the direct costs and benefits of this alternative would be minimal (as it would simply continue the existing regulatory requirements for broker-dealers engaging in retail forex transactions), it nevertheless could have broader impacts on the markets given that other regulators have now adopted or proposed final rules with various specific requirements relating to retail forex that impose different requirements on market intermediaries than those the Commission imposes on broker-dealers under Rule 15b12-1T.[46] The lack of comparable rules across the various intermediaries engaging in a retail forex business could lead to regulatory arbitrage or regulatory gaps. The Commission is considering alternatives, including proposing rules pertaining to retail forex that are more tailored than Rule 15b12-1T and that would be more closely aligned with those of the other regulators but has deferred a determination pending the resolution by the CFTC of the pending request in the ABA/GFMA Letter concerning the treatment of conversion trades.

## C. Benefits

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46 *Id.*

Rule 15b12-1T was designed to preserve retail customers' access to the forex markets through broker-dealers and so promote efficiency by, for example, permitting retail customers to continue to enter into forex transactions in connection with trades in foreign securities, as part of their brokerage activities until such time as the Commission allows Rule 15b12-1T to expire or adopts final, permanent rules in this area. Without the Commission acting to extend Rule 15b12-1T, broker-dealers would be required to exit certain types of retail forex business, which could require retail customers to engage in forex transactions through a futures commission merchant or other service provider. This could be economically inefficient. In particular, to the extent that access to the foreign exchange markets through broker-dealers provides hedging and conversion opportunities for foreign investments, economic benefits may accrue to retail customers.[47] To the extent that the CFTC takes the view that some or all conversion trades remain subject to the retail forex prohibition, and as noted in the Interim Release, the benefits of these trades may not be as easily or efficiently replicated outside of the broker-dealer.[48] Furthermore, by continuing to preserve a channel for broker-dealers' retail customers to access forex transactions through broker-dealers, the extension of the interim final temporary rule will continue to prevent any loss of competition in the retail forex market that could result if broker-dealers were required to exit the business. Moreover, extending the term of the rule will likely, for the period of the extended term, maintain the status quo for broker-dealers with respect to other regulated intermediaries offering retail forex services, whose regulators have adopted (or have proposed to adopt) rules targeted to retail forex with which those intermediaries must comply.[49] Extending the term of

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47 *See* Interim Release at 41684.

48 *See id.*

49 *See supra* note 6.

the rule would not necessarily promote competition between broker-dealers and the other regulated intermediaries, as broker-dealers would continue to offer retail forex services under Rule 15b12-1T which, in general, imposes requirements that arguably could be viewed as less burdensome that those that have become (or are proposed to become) applicable to other regulated intermediaries. Competition among broker-dealers would most likely not be affected by extending the term of the rule.

Because the regulatory requirements for broker-dealers operating in the retail forex market will remain unchanged, extending the expiration date of Rule 15b12-1T will impose no new burden on competition. Similarly, since the rule preserves an existing regulatory structure, the Commission does not expect that extending the term of the rule would result in any potential impairment of the capital formation process.

**D. Costs**

Because Rule 15b12-1T preserves the regulatory regime that had been in place prior to the effective date of Section 742(c) of the Dodd-Frank Act, the extension of the rule imposes no new regulatory burdens beyond those that already existed for broker-dealers engaged in a retail forex business. The Commission recognizes that broker-dealers will face regulatory costs and requirements associated with operating in the retail forex market, but these costs and requirements are those they already shouldered from engaging in the business.[50] As discussed

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50 As described in the Interim Release, these costs include costs related to disclosure, recordkeeping and documentation, capital and margin, reporting, and business conduct. A broker-dealer that currently engages in forex transactions with retail customers, for example, incurs costs associated with establishing, maintaining, and implementing policies and procedures to comply with regulatory requirements; preparing disclosure documents; establishing and maintaining forex-related business records; and preparing filings with the Commission, which may include legal and accounting fees. Interim Release at 41684.

above and in the Interim Release, the Commission is aware of potentially abusive practices that may be occurring in the retail forex market.[51] To the extent that such practices continue, customers may bear the costs associated with these abuses. We are monitoring potential fraud involved in forex within our jurisdiction,[52] and our staff has also alerted investors to the risks of retail forex trading.[53] The Commission believes, on balance, that the cost of market disruption that may occur if the Commission does not extend Rule 15b12-1T, particularly with respect to conversion transactions that may not be easily replicated outside of the broker-dealer,[54] justifies the cost of maintaining the current regulatory regime while the Commission considers proposing rules in light of additional developments, including the recent request for the CFTC's interpretation regarding conversion trades.[55]

### E. Conclusion

Because the extension of Rule 15b12-1T will not affect the regulatory requirements for broker-dealers operating in the retail forex market, this extension will impose no new burden on competition. Similarly, because the rule's extension does not alter the existing regulatory structure, the Commission does not expect any potential impairment of the capital formation process. To the extent that potentially abusive practices continue in the retail forex market, the

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52 For instance, we recently brought an enforcement action against the CEO of a purported foreign currency trading firm, alleging fraud by that person. *See SEC v. Jeffery A. Lowrance, et al.*, Case No. CV-11-3451, press release, complaint and litigation release, available at http://www.sec.gov/news/press/2011/2011-147.htm.

53 *See Investor Bulletin: Foreign Currency Exchange (Forex) Trading for Individual Investors* (July 2011), available at http://www.sec.gov/investor/alerts/forextrading.pdf.

54 *See* Interim Release at 41684.

55 *Id.*

market will continue to bear the costs associated with any such abuses and the resultant inefficient provision of services across the market. Because extending Rule 15b12-1T does not alter the existing regulatory structure or regime, the Commission does not expect any potential impairment of the capital formation process, especially as the rule's extension allows retail customers to continue to have access through broker-dealers to hedging transactions, conversion trades, and other forex transactions, without the need to shift business and open new accounts at other market intermediaries.

## IV. Paperwork Reduction Act

Rule 15b12-1T does not impose any new "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA"),[56] or create any new filing, reporting, recordkeeping, or disclosure reporting requirements for broker-dealers that are or plan to be engaged in a retail forex business. In the Interim Release, the Commission requested comment on its conclusion that there are no collections of information.[57] The Commission received no comments relating to the PRA analysis. Accordingly, the Commission maintains its PRA analysis set forth in the Interim Release for purposes of this extension.

## V. OTHER MATTERS

### A. Administrative Procedure Act

The Administrative Procedure Act generally requires an agency to publish notice of a proposed rulemaking in the Federal Register.[58] This requirement does not apply, however, if the agency "for good cause finds . . . that notice and public procedure are impracticable,

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56 44 U.S.C. 3501 *et seq.*

57 *See* Interim Release at 41683-84.

58 *See* 5 U.S.C. 553(b).

unnecessary, or contrary to the public interest."[59] The Administrative Procedure Act also generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective.[60] This requirement, however, does not apply if the agency finds good cause for making the rule effective sooner.[61] The Commission finds that there is good cause to extend the expiration date of Rule 15b12-1T to July 16, 2013, without notice and comment and not to delay the effective date of the extension. The Commission further finds that notice and solicitation of comment on the extension is impracticable, unnecessary, or contrary to the public interest.[62]

As discussed above, on April 18, 2012, a group of commenters asked the CFTC, as well as other Federal regulatory agencies (including the Commission), to find that forex transactions that are solely incidental to, and are initiated for the sole purpose of, permitting a client to complete a transaction in a foreign security, so-called "conversion trades," would not be subject to the retail forex prohibition under section 2 of the CEA.[63] We anticipate that the CFTC will address this request in the context of the Products Definition Release. An interpretation by the CFTC that conversion trades are not subject to the statutory prohibition could affect the need for, or the extent and reach of, any Commission rulemaking for retail forex transactions generally. Commenters have stated that conversion trades comprise the vast majority of retail

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59 *Id.*

60 *See* 5 U.S.C. 553(d).

61 *Id.*

62 *See* 5 U.S.C. 553(b) and (d).

63 *See* ABA/GFMA Letter.

forex transactions engaged in by broker-dealers,[64] and permitting conversion trades by broker-dealers was one of the reasons we adopted Rule 15b12-1T.[65] As we previously have noted, there are other types of forex transactions broker-dealers engage in which may be potentially beneficial for retail customers, such as using forex to hedge portfolio currency risk or to provide portfolio diversification.[66] The potential CFTC interpretation means that further rulemaking could well confront a very different set of transactions than contemplated in April 2012, one focused not on conversion trades, but rather on these other types of forex transactions. It also means that further rulemaking would need to consider whether there are classes of conversion trades not excluded under any final interpretation that may be adopted by the CFTC that must be addressed separately. Accordingly, if the CEA is interpreted so that certain conversion trades would not be prohibited, we would want to consider what, if anything, we believe is appropriate with respect to proposing and adopting a permanent rule in this area in light of the diverse classes of transactions – beyond the conversion trades that have been the focus of comments to date – that any such rule may need to consider. Accordingly, in view of these very recent developments, the Commission has determined that it would be impracticable to publish notice of the proposed extension.

In making this finding of good cause,[67] the Commission has decided to maintain the current regulatory regime in order to avoid disruption for investors engaging in retail forex

64 *See* Morgan Lewis Letter.

65 *See* Interim Release at 41684.

66 *See id. See also* SIFMA/ISDA Letter (Annex A, Part I).

67 This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the rules to become effective notwithstanding the requirement of 5 U.S.C. 801 (if a federal agency finds that notice and public comment are "impractical, unnecessary or contrary to the

transactions through broker-delaers, until such time as the Commission makes any final decision with regard to permanent rulemaking in this area, in light of any potential interpretation by the CFTC. In particular, the Commission considered that not extending the expiration date, or allowing the extension to be delayed, would cause disruption to the markets and potentially harm investors, as retail forex transactions, including conversion trades, would, as of July 16, 2012, the original expiration date of Rule 15b12-1T, be prohibited. For the same reasons, the Commission finds good cause not to delay the effective date of this extension for 30 days.

In the event that the Commission determines to propose a permanent rule to replace Rule 15b12-1T, the Commission will provide notice and solicit comment on that proposal.

**B. Regulatory Flexibility Act Certification**

In the Interim Release, the Commission certified that pursuant to 5 U.S.C. 605(b), Rule 15b12-1T would not have a significant economic impact on a substantial number of small entities. As explained in the Interim Release, although Rule 15b12-1T applies to broker-dealers that may engage in retail forex transactions, which may include small businesses, any costs or regulatory burdens incurred as a result of the rule are the same as those incurred by small broker-dealers prior to the effective date of Section 742 of the Dodd-Frank Act.[68] We also noted that the rule would impose no new regulatory obligations, costs, or burdens on such broker-dealers. Thus, there would not be a significant economic impact on a substantial number of small entities. In the Interim Release, we requested comment on our conclusion that Rule 15b12-1T should not have a significant economic impact on a substantial number of small entities. The Commission received no comments addressing this issue. In light of this, as well as the fact that we are

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public interest," a rule "shall take effect at such time as the federal agency promulgating the rule determines").

68 *See id.* at 41684-85.

making no change to Rule 15b12-1T apart from extending its expiration date, we hereby certify pursuant to 5 U.S.C. 605(b) that extending Rule 15b12-1T will not have a significant economic impact on a substantial number of small entities.

## VI. STATUTORY AUTHORITY AND TEXT OF RULE AND AMENDMENT

Pursuant to section 2(c)(2) of the Commodity Exchange Act, as well as the Exchange Act as amended, the Commission is amending Exchange Act Rule 15b12-1T.

**List of Subjects in 17 CFR Part 240**

Brokers, Consumer protection, Currency, Reporting and recordkeeping requirements. In accordance with the foregoing, the Securities and Exchange Commission is amending Title 17, chapter II, of the Code of Federal Regulations as follows:

**TEXT OF THE RULE AND AMENDMENT**

**PART 240 - GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

1. The general authority citation for Part 240 continues to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et. seq.; 18 U.S.C. 1350; 12 U.S.C. 5221(e)(3); and 7 U.S.C. 2(c)(2)(E), unless otherwise noted.

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**§ 240.15b12-1T [Amended]**

2. Revise paragraph (d) of § 240.15b12-1T to read as follows:

**§ 240.15b12-1T Brokers or dealers engaged in a retail forex business.**

* * * * *

(d) This section will expire and no longer be effective on July 16, 2013.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

August 10, 2012

Commissioner [illegible]
Commissioner Paredes
not participating

# UNITED STATES OF AMERICA
## Before the
## SECURITIES AND EXCHANGE COMMISSION

**SECURITIES ACT OF 1933**
**Release No. 9350 / August 14, 2012**

**ADMINSITRATIVE PROCEEDING**
**File No. 3-14982**

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| In the Matter of<br><br>**WELLS FARGO BROKERAGE SERVICES, LLC n/k/a WELLS FARGO SECURITIES, LLC,**<br><br>Respondent. | **ORDER UNDER RULE 602(e) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE Rule 602(c)(3) DISQUALIFICATION PROVISION** |

I.

Wells Fargo Brokerage Services, LLC n/k/a Wells Fargo Securities, LLC ("Wells Fargo" or "Respondent") has submitted a letter, dated August 14, 2012, requesting a waiver of the Rule 602(c)(3) disqualification from the exemption from registration under Regulation E under the Securities Act of 1933 arising from Wells Fargo's settlement of administrative and cease-and-desist proceedings instituted by the Commission.

II.

On August 14, 2012, pursuant to Respondent's Offer of Settlement, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 15(b) of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order") against Respondent.

The Order censures Respondent and finds that by engaging in a course of business where it recommended and sold asset-backed commercial paper to certain institutional customers without obtaining sufficient information about the nature and risk of the product, Respondent violated Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 ("Securities Act"). Without admitting or denying the findings in the Order, except as to the Commission's jurisdiction over it and the subject matter of the proceedings, Respondent consented to the Order. The Order also requires Respondent to cease and desist from committing or causing violations and future violations of the preceding provisions and to pay a civil penalty of $6.5 million and disgorgement of $65,000 plus additional prejudgment interest.

III.

Regulation E provides an exemption from registration under the Securities Act, subject to certain conditions, for securities issued by certain small business investment companies and business development companies. Rule 602(c)(3) makes this exemption unavailable for the securities of such an issuer if, among other things, any of its principal security holders, or any investment adviser or underwriter of the securities to be offered is "subject to an order of the Commission entered pursuant to Section 15(b)" of the Exchange Act. Rule 602(e) provides, however, that the disqualification ". . . shall not apply . . . if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption [from registration pursuant to Regulation E] be denied." 17 C.F.R. § 230.602(e).

IV.

Based on the representations set forth in Wells Fargo's request, the Commission has determined that pursuant to Rule 602(e) under the Securities Act a showing of good cause has been made that it is not necessary under the circumstances that the exemption be denied as a result of the Order.

Accordingly, **IT IS ORDERED,** pursuant to Rule 602(e) under the Securities Act, that a waiver from the application of the disqualification provision of Rule 602(c)(3) under the Securities Act resulting from the Commission's Order is hereby granted.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Paredes
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9351 / August 14, 2012

SECURITIES EXCHANGE ACT OF 1934
Release No. 67651 / August 14, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14982

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| In the Matter of<br><br>WELLS FARGO BROKERAGE SERVICES, LLC, now known as WELLS FARGO SECURITIES, LLC,<br><br>Respondent. | ORDER UNDER SECTION 27A(b) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b) OF THE SECURITIES EXCHANGE ACT OF 1934, GRANTING WAIVERS OF THE DISQUALIFICATION PROVISIONS OF SECTION 27A(b)(1)(A)(ii) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b)(1)(A)(ii) OF THE SECURITIES EXCHANGE ACT OF 1934 |

Wells Fargo Brokerage Services, LLC, now known as Wells Fargo Securities, LLC, ("Wells Fargo" or "Respondent") has submitted a letter, dated August 14, 2012, requesting a waiver for itself and any of its affiliates or any other person identified in Section 27A(a) of the Securities Act of 1933 ("Securities Act") or Section 21(E)(a) of the Securities Exchange Act of 1934 ("Exchange Act"), of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act arising from Respondent's settlement of a cease-and-desist and administrative proceeding instituted by the Commission. On August 14, 2012, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 15(b) of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order") against Respondent.

The Order censures Respondent and finds that by engaging in a course of business where it recommended and sold asset-backed commercial paper to certain institutional customers without obtaining sufficient information about the nature and risk of the product, Respondent violated Sections 17(a)(2) and 17(a)(3) of the Securities Act. Without admitting or denying the findings in the Order, except as to the Commission's jurisdiction over it and the subject matter of the proceedings, Respondent consented to the Order. The Order also requires Respondent to cease and desist from committing or causing violations and future violations of the preceding provisions and to pay a civil penalty of $6.5 million and disgorgement of $65,000 plus additional prejudgment interest.

The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act are not available for any forward looking statement that is "made with respect to the business or operations of an issuer, if the issuer . . . during the 3-year period preceding the date on which the statement was first made . . . has been made the subject of a judicial or administrative decree or order arising out of a governmental action that (I) prohibits future violations of the antifraud provisions of the securities laws; (II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or (III) determines that the issuer violated the antifraud provisions of the securities laws[.]" Section 27A(b)(1)(A)(ii) of the Securities Act; Section 21E(b)(1)(A)(ii) of the Exchange Act. The disqualifications may be waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Section 27A(b) of the Securities Act; Section 21E(b) of the Exchange Act.

Based on the representations set forth in Wells Fargo's August 14, 2012, 2012 request, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the entry of the Order is appropriate and should be granted.

Accordingly, IT IS ORDERED, pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that a waiver from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to Wells Fargo and any of its affiliates or any other person identified in Section 27A(a) of the Securities Act or Section 21(E)(a) of the Exchange Act resulting from the Commission's Order is hereby granted.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Paredes
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9349 / August 14, 2012

SECURITIES EXCHANGE ACT OF 1934
Release No. 67649 / August 14, 2012

INVESTMENT COMPANY ACT OF 1940
Release No. 30167 / August 14, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14982

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|---|---|
| In the Matter of<br><br>Wells Fargo Brokerage Services, LLC n/k/a Wells Fargo Securities, LLC and Shawn Patrick McMurtry<br><br>Respondents. | ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER |

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted, pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act ("Exchange Act"), against Wells Fargo Brokerage Services, LLC n/k/a Wells Fargo Securities, LLC ("Wells Fargo"), and that public administrative and cease-and-desist proceedings be, and hereby are, instituted, pursuant to Section 8A of the Securities Act, Section 15(b) of the Exchange Act and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Shawn McMurtry ("McMurtry") (Wells Fargo and McMurtry collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 15(b) of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

## III.

On the basis of the Order and the Respondents' Offers, the Commission finds[1] that:

### Summary

1. From at least January 1, 2007 through August 14, 2007 ("relevant time period"), Wells Fargo and certain of its registered representatives made recommendations to certain institutional customers to purchase asset-backed commercial paper issued by limited purpose companies called Structured Investment Vehicles ("SIVs"), which were complex investment vehicles backed largely by high-risk mortgage-backed securities ("MBS") and collateral debt obligations ("CDOs"). Wells Fargo registered representatives in Wells Fargo's Institutional Brokerage and Sales Division, including McMurtry, recommended and sold these asset-backed commercial paper investments to certain institutional customers, including municipalities and non-profit institutions.

2. During the relevant time period, Wells Fargo and certain of its registered representatives recommended and sold complex forms of SIV-issued asset-backed commercial paper to institutional customers without obtaining sufficient information and understanding about the nature and risk of these products. Among other things, Wells Fargo and its registered representatives did not review the commercial paper private placement memoranda ("PPMs") for the investments and the extensive risk disclosures in those documents. Instead, Wells Fargo and its registered representatives relied almost exclusively on the credit ratings of these products, despite warnings against such over-reliance on ratings. Wells Fargo also failed to establish any procedures to ensure that its personnel adequately reviewed and understood the nature and risks of these commercial paper programs. As a result, Wells Fargo and its registered representatives failed to: (i) have a reasonable basis for their recommendations; and (ii) in connection with their recommendations, disclose to their institutional customers the risks associated with the complex SIV-issued asset-backed commercial paper investments, including the nature and volatility of the underlying assets. A number of institutional customers purchased SIV-issued asset-backed commercial paper as a result of Wells Fargo's recommendations. In particular, McMurtry exercised discretionary authority in violation of Wells Fargo's internal policy and selected the particular issuer of asset-backed commercial paper for one long-standing municipal customer. Although Wells Fargo received a small amount of commissions from these transactions, Wells Fargo's

[1] The findings herein are made pursuant to the Respondents' Offers and are not binding on any other person or entity in this or any other proceeding.

misconduct nevertheless resulted in, or created a significant risk of, substantial losses by these customers in 2007 when three SIV-issued asset-backed commercial paper programs, which were backed largely by MBS and CDOs, defaulted.

3. Wells Fargo and McMurtry were, at a minimum, negligent in recommending the relevant asset-backed commercial paper programs without obtaining adequate information about them to form a reasonable basis for recommending these products and without disclosing the material risks of these products. As a result, Wells Fargo and McMurtry violated Sections 17(a)(2) and 17(a)(3) of the Securities Act.

## Respondents

4. Wells Fargo Brokerage Services, LLC was a registered broker-dealer subsidiary of Wells Fargo & Co. with its principal place of business in Minneapolis, Minnesota. On December 31, 2008, Wells Fargo & Co., the parent of Wells Fargo Brokerage Services, LLC, acquired the former Wachovia Corporation ("Wachovia"). In 2009, Wells Fargo Brokerage Services, LLC was combined with Wachovia's former institutional broker-dealer business, Wachovia Capital Markets LLC, which now operates as Wells Fargo Securities, LLC. Wells Fargo Brokerage Services, LLC de-registered as a broker-dealer with the Commission in November 2009.

5. Shawn Patrick McMurtry, age 42, a resident of White Bear Lake, Minnesota, was employed by Wells Fargo or a predecessor from the time he graduated from college in June 1992 until he voluntarily terminated his employment in June 2012. Respondent McMurtry obtained his Series 7 and Series 63 licenses in July 1996 and became a registered representative in 2001. During the relevant time period, McMurtry was a Vice President in Wells Fargo's Institutional Brokerage and Sales Division, and recommended and sold primarily fixed income securities to corporations, insurance companies, non-profit institutions, public entities and money managers.

## Wells Fargo Targeted Municipalities and Non-Profit Customers

6. Before and during 2007, the Institutional Brokerage and Sales Division of Wells Fargo had targeted municipalities and non-profit institutions as part of its institutional customer base ("municipal customers").

7. Wells Fargo and its registered representatives routinely requested municipal customers' investment policies to facilitate their recommendations. The first priority in the investment policies of many municipal customers was preservation of principal. Registered representatives frequently certified to these municipal customers on at least an annual basis that they understood the municipal customers' investment policies. In addition, many municipal customers had long-term relationships with Wells Fargo and individual registered representatives.

8. Wells Fargo and its registered representatives knew, both from their customers' investment policies and from discussions with customers, that many of their municipal

customers were interested in investing in conservative commercial paper.[2] Many of these customers needed to invest cash in instruments that allowed them timely access to the funds while obtaining an investment return.

9. Based on, among other things, the nature and longevity of their business relationships, many municipal customers placed a high level of trust in and reliance on their registered representatives. Customers that were permitted to purchase commercial paper generally would inform their registered representatives of the amount of money they had available for investment and the length of time they wished to invest it. Wells Fargo registered representatives typically would then respond with recommendations that included commercial paper. The commercial paper recommendations, which were based almost solely on the ratings assigned by the credit rating agencies, usually consisted of approximately three commercial paper investment choices that met the customers' criteria. Customers would then select one of the commercial paper investments recommended by the Wells Fargo registered representatives. Multiple registered representatives at Wells Fargo, including McMurtry, however, had a practice of exercising discretionary authority to make purchases of asset-backed commercial paper on behalf of certain customers. In these situations, the customer still informed the registered representative of the amount of money available for investment and the length of time for the investment, but permitted the registered representative to then select the particular commercial paper investment and execute the purchase of that investment for the customer.

**Wells Fargo Recommended Complex SIV-Issued Asset-Backed Commercial Paper to Its Municipal Customers Without Reviewing the Private Placement Memoranda and Risk Disclosures of the Asset-Backed Commercial Paper**

10. Wells Fargo and its registered representatives had historically sold highly-rated traditional direct corporate commercial paper to municipal customers. In addition to traditional commercial paper, many customers also purchased asset-backed commercial paper through Wells Fargo. Similar to direct commercial paper, asset-backed commercial paper was rated by various credit rating agencies.

11. The asset-backed commercial paper Wells Fargo sold to its municipal customers was not registered and thus the PPMs for those investments were not normally available to the general public. Customers accordingly could only obtain access to the information in the PPMs, or copies of the PPMs, from a professional in the securities industry. Wells Fargo generally did not provide the PPMs to customers in connection with commercial paper transactions.

12. It was not Wells Fargo's practice to conduct any review of the asset-backed commercial paper it recommended to customers and did not have procedures that required such a review. In addition, no department or individual inside of Wells Fargo was required to conduct any review of the offering documents or similar disclosure documents. In addition, no department or individual inside of Wells Fargo was required to assess any unique risks to the commercial paper type, the particular issuer or its structure. Instead, Wells Fargo and its

[2] Commercial paper generally consists of short-term, unsecured promissory notes with fixed maturities, issued by corporations or other entities.

registered representatives relied largely on the credit ratings as the basis for their recommendations.

13. By 2007, in addition to the traditional direct corporate commercial paper, and the more established forms and issuers of asset-backed commercial paper that Wells Fargo had offered to its customers, other more unusual asset-backed commercial paper issued by complex investment vehicles was being created and sold in the marketplace. These newer commercial paper investments included asset-backed commercial paper programs that were collateralized by subprime mortgages. Some of this asset-backed commercial paper was issued by SIVs, little-known limited purpose companies that generally undertook arbitrage activities by buying primarily highly rated medium and long-term fixed-income assets, which they then funded through the sale of less expensive commercial paper and/or notes.

14. Some of the asset-backed commercial paper was issued by so-called "SIV-Lites," which also engaged in similar arbitrage activity but generally did not have the asset diversification of a SIV. In addition, SIV-Lites often were highly leveraged and the highest proportion of their assets consisted of residential mortgage-backed securities, many of which were derived from sub-prime mortgages. The SIV/SIV-Lite marketplace was at its height in 2007.

15. SIVs and SIV-Lites invested extensively in securities backed by subprime mortgages or related derivatives such as CDOs. The primary collateral of the asset-backed commercial paper issued by these entities thus was MBS and derivatives purchased by these special entities, which had little or no other assets. As a result, these asset-backed commercial paper programs were particularly exposed to risks associated with MBS and derivatives thereof.

16. Wells Fargo recommended and sold asset-backed commercial paper in its role as a broker for its institutional customers. Wells Fargo did not underwrite or participate in the issuance of, or act as a program dealer for, the SIV/SIV-Lite-issued asset-backed commercial paper, nor did Wells Fargo have any role in structuring the SIVs or SIV-Lites or in selecting their investments.

17. As SIVs and SIV-Lites became increasingly present in the marketplace, Wells Fargo did not change its practices as to the review or disclosure of risks of commercial paper. Thus, in 2007, no one at Wells Fargo was responsible for reviewing, and generally no one reviewed, the PPMs of asset-backed commercial paper programs to assess any specialized risks to the particular security or its structure. Accordingly, the registered representatives had little information about these securities beyond their ratings, yields and maturity dates. In fact, multiple registered representatives at Wells Fargo had never heard of a SIV at the time they were selling the SIV-issued asset-backed commercial paper to their customers. As a result of their failure to understand these products, the registered representatives made no distinctions among traditional direct corporate commercial paper, asset-backed commercial paper and unusually structured SIV-issued asset-backed commercial paper. Despite their lack of knowledge regarding these complex products, in 2007, Wells Fargo and certain of its registered representatives recommended asset-backed commercial paper that was backed by MBS and issued by SIV/SIV-Lites. They made recommendations based almost solely on the ratings that the credit rating agencies assigned to the commercial paper.

## Wells Fargo's Misconduct Resulted in or Created a Significant Risk of Substantial Losses to Customers

18. A number of the municipal customers had indicated in Wells Fargo account opening documents that they did not want to invest in MBS. Other municipal customers were prohibited by state law from holding certain MBS and these restrictions were set forth in the customers' investment policies or other documents in Wells Fargo's possession. However, because no one at Wells Fargo read the relevant disclosure documents for the asset-backed commercial paper in question, Wells Fargo offered customers asset-backed commercial paper programs that were materially exposed to the MBS market.

19. In 2007, Wells Fargo sold, among others, three SIV-Lite programs that had received the highest ratings from each of the three major credit rating agencies: Rhinebridge PLC ("Rhinebridge"), Mainsail II Ltd. ("Mainsail") and Golden Key Ltd. ("Golden Key").[3] The PPMs for all three products stated that the issuers were limited liability companies specifically formed to invest in MBS and other complex securities, such as CDOs, and that they were issuing asset-backed commercial paper to obtain short-term financing for these securities and derivatives.

20. The market for asset-backed commercial paper contracted severely beginning in mid-August 2007 due in part to the increased market perception of the risk of subprime mortgages, which formed much of the collateral for a number of SIV-issued asset-backed commercial paper programs. As a result, credit rating agencies downgraded a number of SIV-issued asset-backed commercial paper programs and, ultimately, many defaulted.

21. In August 2007, Mainsail and Golden Key defaulted. Rhinebridge, after having been on the market for only four months, defaulted in October 2007.

22. Approximately ten Wells Fargo customers were holding a total of approximately $104.4 million in commercial paper issued by Mainsail, Golden Key and Rhinebridge when the defaults occurred. These three defaults resulted in, or created a significant risk of, substantial losses for these ten customers. Wells Fargo's total commission in 2007 for the sale of Mainsail, Golden Key and Rhinebridge was approximately $65,000.

23. The PPMs for these asset-backed commercial paper programs provided clear disclosure about the risks associated with the products. In fact, the PPMs for these three SIVs each contained approximately 20-30 pages of risk disclosures. These risks included Risks Relating to Nonprime and other Mortgage Backed Securities, Risks Related to Investments Backed by Residential Mortgages, Risks Related to Commercial Mortgage Backed Securities, Risks Related to CDOs and Synthetic Securities, Considerations Related to Asset Backed Securities, Spread Risk, International Risk, Credit Risk and others. In addition, many of the PPMs had language specifically identifying a market decline in the residential mortgage market.

[3] For example, Rhinebridge, Golden Key and Mainsail II each had been rated A1+ (a Standard & Poor's rating) or P1 (a Moody's rating), the highest possible ratings awarded by those credit rating agencies, at the time the Wells Fargo customers bought them.

24. In each case, the very scenario that took place in the market in 2007 had been described with precision in the risk disclosures in the PPMs. For example, Mainsail's July 2007 PPM specifically stated that "According to recently published reports, the residential mortgage market in the US has experienced a variety of difficulties and changed economic conditions that may adversely affect the performance and market value of US Residential ABS Securities… Delinquencies, defaults and losses with respect to residential mortgage loans generally reportedly have increased in recent months, and may continue to increase, particularly in the subprime sector. In addition, in recent months published reports have indicated that housing prices and appraisal values may result in additional increases in delinquencies and losses on US Residential Asset Backed Securities."

25. Because the Wells Fargo registered representatives had not reviewed the PPMs, or otherwise investigated the programs before recommending asset-backed commercial paper to their customers, they were unaware of the risks. They accordingly did not disclose these risks to customers or factor them into their recommendations.

26. As a result of this lack of adequate knowledge of the products they were selling, Wells Fargo and certain of its registered representatives recommended and sold SIV-issued asset-backed commercial paper to customers without adequate basis and without disclosure to customers of the relevant risks. They also did not disclose to these customers their lack of investigation regarding the programs.

27. Wells Fargo and its registered representatives' failures to have a reasonable basis for their recommendations and to disclose the risks associated with the products they recommended and sold were particularly significant failures, in light of the fact that many Wells Fargo customers had advised that they either did not want, or were legally prohibited from purchasing, MBS.

**Contemporaneous Warnings Against Over-Reliance on Credit Ratings**

28. In 2005, the NASD (now FINRA) issued a written warning specifically cautioning against over-reliance on credit ratings in connection with structured products. In a September 2005 Notice to Members, the NASD provided guidance on the sale of structured products. The Notice stated:

> "In some cases, structured products are assigned a credit rating by a nationally recognized statistical rating organization. To the extent that such credit rating pertains to the creditworthiness of the issuer (*i.e.*, the ability of the issuer to meet its obligations under the terms of the structured product) and is not indicative of the market risk associated with the structured product or the reference security, members must be careful to delineate these distinctions. ***Presentation of a credit rating for a structured product that suggests that the rating pertains to the safety of the principal invested or the likely investment returns will be viewed as misleading. Members presenting a credit rating must address the fact that the creditworthiness of the issuer does not affect or enhance the likely performance of the investment other than the ability of the issuer to meet its obligations***. (emphasis added)"

29. At least one of the SIV PPMs explained that the collateral assets of the programs were "structured finance securities."

30. Similarly, cautionary statements in many of the PPMs warned against such over-reliance on credit ratings. For example, the Rhinebridge PPM included a disclaimer that "a rating does not comment as to...suitability for a particular investor...."

31. Nevertheless, Wells Fargo and certain of its registered representatives relied almost exclusively on the credit ratings assigned to asset-backed commercial paper programs in making recommendations to their customers.

**<u>Wells Fargo's Sale of SIV-Lite Asset-Backed Commercial Paper</u>**

32. One particular municipal entity had been a customer of Wells Fargo, or a predecessor, since at least 1988. This customer's investment objectives were safety of principal and income. Wells Fargo had a policy that prohibited its registered representatives from selecting investments on behalf of their customers in the absence of express written authority to do so. Nonetheless, Respondent McMurtry, who held the title of Vice President, selected which commercial paper issuers this municipal entity would purchase and executed the investments on the customer's behalf. Wells Fargo's internal records for the customer's account specifically stated that the account should not invest in MBS. In addition, applicable state law prohibited municipal entities such as this customer from investing in certain "high-risk mortgage-backed securities."

33. Respondent McMurtry nevertheless selected and purchased for this municipal customer a SIV-issued asset-backed commercial paper program which was backed by MBS and related high-risk mortgage-backed derivatives. In selecting the commercial paper issuer for the customer, McMurtry was exercising discretionary authority. On April 30, 2007, McMurtry selected and purchased Golden Key on behalf of the customer. McMurtry did not know what a SIV was at that time he selected Golden Key for his customer. Further, he did not read the PPM for Golden Key, nor did he inform the customer of the risks related to the SIV structure or the underlying high-risk mortgage-backed assets held by Golden Key.

34. The municipal customer's investment in Golden Key was due to mature on September 28, 2007, but was downgraded on August 23, 2007 and defaulted thereafter. Until the default of Golden Key, the customer's representatives believed Wells Fargo purchased only traditional commercial paper on its behalf. It was only after the default that they learned about the risks and nature of Golden Key asset-backed commercial paper.

**<u>Subsequent Developments</u>**

35. In or about August 2007, as the market for asset-backed commercial paper contracted severely, Wells Fargo determined that credit ratings did not accurately reflect the risks of certain asset-backed commercial paper. As a result, on August 15, 2007, Wells Fargo made the decision to suspend the sale of all asset-backed commercial paper to its customers.

36. In addition, as part of the liquidation of Golden Key, Mainsail and Rhinebridge, two of the ten Wells Fargo customers elected to receive a one-time cash distribution at a severe

discount to the amounts of their original investments. As a result, these two customers realized losses of approximately $4.2 million. Another six Wells Fargo customers, however, elected to receive periodic payments from the underlying assets that served as collateral to the SIV asset-backed commercial paper. As such, the amount of any loss that may be realized by these six Wells Fargo customers has not yet been determined because it is dependent upon the amount of future payments from these underlying assets.

37. In addition, two other of these ten Wells Fargo customers filed lawsuits against Wells Fargo in connection with their purchases of approximately $8.5 million of asset-backed commercial paper from Rhinebridge and Golden Key. One of these customers received $4,629,800 in a cash distribution as part of the liquidation of the investment and Wells Fargo, in settlement of the claims against it, subsequently paid $4,157,971 to that customer. In addition, Wells Fargo paid $489,410 to the second customer to settle its claim.

38. Since 2007, Wells Fargo has taken a number of remedial measures designed to ensure that Wells Fargo and its registered representatives have adequate information about the nature and risk of the securities that they recommend to customers, and that relevant information will be disclosed to the customers regarding such securities. The steps include: (1) a Wells Fargo Asset-Backed Commercial Paper Permitted List wherein the offering documents for asset-backed commercial paper are reviewed by money market traders and a limited number of commercial paper products are permitted for sale to institutional customers; (2) enhanced supervisory procedures related to the assessment of product knowledge by registered representatives in the relevant designated sales force who sell commercial paper to municipalities; (3) quarterly meetings attended by the heads of each fixed income trading desk, the national sales manager and representatives of the compliance department during which products sold to municipal and other customers and developments in those product types are reviewed as are the relevant trading desk reports on variations or modifications in the market that presently raise or are expected to raise materially new or different risks or that exhibit other characteristics that may require reassessment of the sales force's understanding of the product; and (4) the practice of delivering, or providing electronic access to, copies of offering materials to purchasers of asset-backed commercial paper.

## Legal Discussion

39. Section 17(a)(2) of the Securities Act prohibits any person, in the offer or sale of any security, from obtaining money or property by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. Section 17(a)(3) of the Securities Act prohibits any person, in the offer and sale of any security, from engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. Sections 17(a)(2) and 17(a)(3) of the Securities Act do not require a showing of scienter. Aaron v. SEC, 466 U.S. 680 (1980). A showing of negligence is sufficient to establish violations of these provisions. Id. at 701-702.

40. A broker's recommendation "carries the implicit representation that it was 'responsibly made on the basis of actual knowledge and careful consideration.' Richard G. Cody, Exchange Act Rel. No. 64565 at 12 (May 27, 2011) *citing* F.J. Kaufman & Co. of Va., 50

S.E.C. 164, 168 n. 18 (1989) (*citing* Alexander Reid & Co., Inc., 40 S.E.C. 986, 990-91 (1962) ('A broker-dealer in his dealings with customers impliedly represents that his opinions and predictions respecting a [security] which he has undertaken to recommend are responsibly made on the basis of actual knowledge and careful consideration . . . . [I]t is not a sufficient excuse that a dealer personally believes the representation for which he has no adequate basis.'); Distribution by Broker-Dealers of Unregistered Securities, Exchange Act Rel. No. 6721 (Feb. 2, 1962) ('[T]he making of recommendations for the purchase of a security implies that the dealer has a reasonable basis for such recommendations which, in turn, requires that, as a prerequisite, he shall have made a reasonable investigation.') *See also* Hanly v. SEC, 415 F.2d 589, 596-597 (2d. Cir. 1969) ("Broker-dealers occupy a special relationship with buyers of securities in that by their position they implicitly represent that they have an adequate and reasonable basis for the opinions they render.") A broker or salesperson who fails to investigate facts surrounding a security and who subsequently recommends that security to customers without having an adequate and reasonable basis for that recommendation may be in violation of the antifraud provisions of the federal securities laws, including Sections 17(a)(2) and 17(a)(3) of the Securities Act. SEC v. Great Lakes Equities, 1990 WL 260587 at*6 (E.D. Mich. Sept. 4, 1990) *citing* Hanly, 415 F.2d at 592. Broker-dealers that recommend securities to their customers have an obligation to disclose all material information the broker-dealer has regarding the securities, including negative information. DeKwiatkowski v. Bear, Stearns & Co. Inc., 306 F.3d 1293, 1302 (2d Cir. 2002) (Broker-dealer "is obliged to give honest and complete information when recommending a purchase or sale"); *see also* Dane S. Faber, Exchange Act Rel. 49216 at 5 (Feb. 10, 2004) (Broker who recommended security to a customer should have disclosed to customer the speculative nature of security.)

41. As a result of the conduct described above, Wells Fargo and McMurtry willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act.[4]

**Wells Fargo's Remedial Efforts**

42. In determining to accept Wells Fargo's Offer, the Commission considered remedial acts undertaken by Wells Fargo.

**IV.**

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in the Respondents' Offers.

Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b) of the Exchange Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

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[4] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

**Wells Fargo**

A. Respondent Wells Fargo shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

B. Respondent Wells Fargo is censured.

C. Respondent Wells Fargo shall, within 10 days of the entry of this Order, pay disgorgement of $65,000, prejudgment interest of $16,571.96 and a civil money penalty in the amount of $6,500,000 to the Securities and Exchange Commission.

**Shawn McMurtry**

D. Respondent McMurtry shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

E. Respondent McMurtry be, and hereby is, suspended from association with any broker, dealer, investment adviser, municipal securities dealer, transfer agent, municipal advisor, or nationally recognized statistical ratings organization, is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, and is suspended from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock, for a period of six months, effective on the second Monday following the entry of this Order.

F. Respondent McMurtry shall provide to the Commission, within thirty (30) days after the end of the six-month suspension period described above, an affidavit that he has complied fully with the suspension.

G. Respondent McMurtry shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of $25,000 to the Securities and Exchange Commission.

**Payments and Distributions**

H. All payments pursuant to paragraphs IV. C and G above, shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to Enterprise Services Center, HQ Bldg, Room 181, AMZ-341, 6500 South MacArthur Blvd, Oklahoma City, OK 73169; and (D) submitted under cover letter that identifies each Respondent as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Peter K.M. Chan, U.S. Securities and Exchange Commission, 175 W. Jackson Boulevard, Suite 900, Chicago, Illinois 60604. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717 and/or SEC Rule of Practice 600.

I. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, interest, and penalties described in Paragraphs IV.C. and G. above. Regardless of whether any such distribution is made from such Fair Fund, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalties, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that any Respondent receiving such offset shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against any of the Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

J. The disgorgement, pre-judgment interest, civil penalties and any other funds which may be paid to the Fair Fund through or as the result of related actions, shall be aggregated in the Fair Fund, which shall be maintained solely at Wells Fargo's expense in an interest-bearing account, and shall be distributed pursuant to a distribution plan (the "Plan"). Respondent Wells Fargo shall retain, solely at Wells Fargo's expense, within 30 days of the date of entry of the Order, the services of a Fund Administrator (the "Administrator"), not unacceptable to the staff of the Commission. The Administrator shall identify the Wells Fargo customers that held positions in the three SIV-Lite issued asset-backed commercial paper programs at the time of their respective defaults, evaluate such customers' claims and propose a plan, subject to the approval of the staff, and effectuate that plan to distribute the Fair Fund resulting from this Order. The Fair Fund shall be used to compensate for customer losses pursuant to the Administrator's plan. Under no circumstances shall any part of the Fair Fund be returned to Wells Fargo or McMurtry. Respondent Wells Fargo shall pay all reasonable costs and expenses of such distribution within thirty (30) days after receipt of an invoice for such services.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67662 / August 15, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3446 / August 15, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14985

| In the Matter of | ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS |
|---|---|
| JASON R. HYATT, | |
| Respondent. | |

## I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Jason R. Hyatt ("Respondent").

## II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Hyatt, along with his partner Jay D. Johnson ("Johnson"), was a managing member and principal of Hyatt Johnson Capital, LLC ("HJ Capital"), which, from 2003 through 2008, acted as an unregistered investment adviser in connection with at least ten Limited Liability Corporations ("LLCs") controlled and managed by HJ Capital ("HJ Capital LLCs"). During that time period, Hyatt and HJ Capital also acted as unregistered broker-dealers in connection with the HJ Capital LLCs' purchases of securities offered by BCI Aircraft Leasing, Inc. Hyatt, 39 years old, is currently in custody of the Federal Bureau of Prisons at Oxford, Wisconsin.

2. On June 4, 2012, a partial final judgment was entered by consent against Hyatt, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act, in the civil action entitled SEC v. Hyatt et al., Civil Action Number 1:08-cv-2224, in the United States District Court for the Northern District of Illinois.

3. The Commission's complaint alleged that, in connection with the sale of these LLC interests, at least $3.6 million in investor funds was misappropriated for, among other things, the operation of a Latin-themed restaurant in Chicago and Hyatt's personal expenses including numerous mortgage payments and substantial home improvements for two homes, as well as art and antiques and luxury automobiles. The complaint also alleged that Hyatt and Johnson received nearly $1.8 million in undisclosed commissions in connection with the HJ Capital LLCs' purchases of securities offered by BCI Aircraft Leasing, Inc.

## IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, Respondent be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

> barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Natter
not participating

**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67679 / August 16, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14986**

**In the Matter of**

**DENNIS L. DESENDER,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Dennis L. DeSender ("DeSender" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Exchange Act, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From 2001 to 2011, DeSender served at various times as Chief Financial Officer, Chief Operating Officer, and an independent financial consultant to Bixby Energy Systems, Inc. ("Bixby"), a privately held Delaware corporation with its principal place of business in Ramsey, Minnesota. DeSender is also the owner and control person of DLD Financial Ltd. ("DLD"), a Minnesota corporation. DeSender was not registered as a broker-dealer or associated with a broker or dealer registered with the Commission. DeSender, 51, is a resident of Minneapolis, Minnesota.

2. On June 4, 2012 a partial final judgment was entered by consent against DeSender, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(a) of the Exchange Act, and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Walker, et al., Civil Action No. 11-cv-3655, in the United States District Court for the District of Minnesota.

3. The Commission's complaint alleged that, from at least 2001 to 2010, in connection with the offer and sale of Bixby securities, DeSender made numerous material misrepresentations and omissions to investors and prospective investors regarding Bixby's coal gasification and liquefaction technologies, the operational capability of Bixby's coal gasification machine, and DeSender's criminal history. The complaint also alleged that DeSender and DLD sold over $12 million in Bixby securities to more than 300 investors. As compensation for their sale of Bixby securities, DeSender and DLD received commissions of at least $3.6 million in transaction-based commissions and warrants to purchase at least 549,000 shares of Bixby common stock. Finally, the complaint alleged that DeSender sold unregistered securities.

4. On September 14, 2011, DeSender pled guilty to one count of securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78ff and 17 C.F.R. § 240.10b-5 before the United States District Court for the District of Minnesota, in United States v. Dennis L. DeSender, CR 11-71 (SRN).

5. The count of the criminal information to which DeSender pled guilty alleged, inter alia, that DeSender did knowingly, willfully, and unlawfully, by the use of means and instrumentalities of interstate commerce, directly and indirectly, use and employ manipulative and deceptive devices in connection with the sale of securities, and did make untrue statements of material facts and omit to state material facts in order to make the statements not misleading in connection with the sale of such securities.

## IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**
**Release No. 3447 / August 16, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14987**

| | |
|---|---|
| **In the Matter of**<br><br>**ROBERT C. BUTLER,**<br><br>**Respondent.** | **ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS** |

## I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Robert C. Butler ("Butler" or "Respondent").

## II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Butler, age 45, resides in Bermuda Dunes, California. Butler has not been registered with the Commission in any capacity.

2. On March 6, 2012, a judgment was entered by consent against Butler, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, in the civil action entitled Securities and Exchange Commission v. Robert C. Butler, et al., Civil Action Number SACV 11-3792 MMM (FFMx), in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that Butler raised at least $3.3 million in an unregistered offering from January 2009 through April 2011. The complaint further alleged that Butler falsely promised investors monthly returns of up to 10% through investments in his day-trading business. The complaint further alleges that Butler never earned such returns, but instead misappropriated investor funds and lost investor funds through unsuccessful trading activity. The complaint also alleged that, to conceal his losses, Butler prepared falsified monthly brokerage account statements that he showed to investors.

## IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Butler's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act, that Respondent Butler be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 67687 / August 17, 2012

Admin. Proc. File No. 3-14864

In the Matter of

HYDROGENETICS, INC.

Respondent

ORDER DISMISSING PROCEEDING

On May 2, 2012, the Commission instituted an administrative proceeding against HydroGenetics, Inc. ("HydroGenetics") under Section 12(j) of the Securities Exchange Act of 1934.[1] The Order Instituting Proceedings alleged that HydroGenetics had violated periodic reporting requirements and sought to suspend or revoke the registration of HydroGenetics's securities.

On April 20, 2012, prior to the institution of this proceeding, HydroGenetics filed a Form 15 to terminate voluntarily the registration of its securities under Exchange Act Section 12(g). Under Rule 12g-4(a), an issuer's registration is terminated ninety days after filing a Form 15, in this case, July 19, 2012.[2] On July 20, 2012, the Division of Enforcement filed a motion to dismiss HydroGenetics from this proceeding. HydroGenetics has not responded to the Division's motion.

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1 15 U.S.C. § 78*l*(j).

2 17 C.F.R. § 240.12g-4(a) (certification of termination of registration under Section 12(g)).

We have determined to grant the Division's motion. HydroGenetics no longer has securities registered under Section 12 of the Exchange Act. Because revocation or suspension of registration are the only remedies available in a proceeding instituted under Section 12(j) of the Exchange Act, we find that it is appropriate to dismiss this proceeding against HydroGenetics.[3]

Accordingly, it is ORDERED that this proceeding be, and it hereby is, dismissed with respect to HydroGenetics, Inc.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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[3] *See, e.g.*, *SGI Int'l*, Securities Exchange Act Rel. No. 66389 (Feb. 13, 2012), 102 SEC Docket 51193, 51194; *Sharon Energy, Ltd.*, Securities Exchange Act Rel. No. 66361 (Feb. 8, 2012), 102 SEC Docket 51033, 51034.

Commissioner Gallagher not participating

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC- 30174; 812-14068]

ReconTrust Company, N.A., et al.; Notice of Application and Temporary Order

August 20, 2012

Agency: Securities and Exchange Commission ("Commission").

Action: Temporary order and notice of application for a permanent order under section 9(c) of the Investment Company Act of 1940 ("Act").

Summary of Application: Applicants have received a temporary order exempting them from section 9(a) of the Act, with respect to an injunction entered against ReconTrust Company, N.A. ("ReconTrust") on August 20, 2012 by the United States District Court for the Western District of Washington (the "Injunction"), until the Commission takes final action on an application for a permanent order. Applicants have requested a permanent order.

Applicants: ReconTrust, BofA Advisors, LLC ("BofA Advisors"), BofA Distributors, Inc. ("BofA Distributors"), Bank of America Capital Advisors LLC ("BACA"), KECALP Inc. ("KECALP"), and Merrill Lynch Global Private Equity Inc. ("MLGPE") (collectively, other than ReconTrust, the "Fund Servicing Applicants," and, together with ReconTrust, the "Applicants").[1]

Filing Date: The application was filed on August 15, 2012, and amended on August 20, 2012.

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[1] Applicants request that any relief granted pursuant to the application also apply to any other company of which ReconTrust is an affiliated person or may become an affiliated person in the future (together with the Applicants, the "Covered Persons").

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on September 14, 2012, and should be accompanied by proof of service on Applicants, in the form of an affidavit, or for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicants, ReconTrust, 1800 Tapo Canyon Road, Simi Valley, CA 93063; BofA Advisors, BofA Distributors and BACA, 100 Federal Street, Boston, MA 02110; and KECALP and MLGPE, 767 Fifth Avenue, 7th Floor, New York, NY 10153.

For Further Information Contact: Emerson S. Davis, Senior Counsel, at (202) 551-6868, or Daniele Marchesani, Branch Chief, at (202) 551-6821 (Division of Investment Management, Office of Investment Company Regulation).

Supplementary Information: The following is a temporary order and a summary of the application. The complete application may be obtained via the Commission's website by searching for the file number, or an applicant using the Company name box, at http://www.sec.gov/search/search.htm or by calling (202) 551-8090.

Applicants' Representations:

1. Each of the Applicants is a direct or indirect wholly-owned subsidiary of Bank of America Corporation ("BAC"). ReconTrust is a chartered national trust bank that, among other things, acts as foreclosure trustee responsible for conducting nonjudicial foreclosures within several states, including the state of Washington until recently. ReconTrust is not registered as a broker-dealer under the Securities Exchange Act of 1934 or as an investment adviser under the Investment Advisers Act of 1940 (the "Advisers Act").

2. BofA Advisors is a registered investment adviser that serves as investment adviser and subadviser to certain money market funds registered under the Act. BofA Distributors, a limited purpose broker-dealer registered with the Commission, serves as principal underwriter of some of the same money market funds. BACA is a registered investment adviser that serves as investment adviser to certain closed-end investment companies also registered under the Act.

3. KECALP and MLGPE each serves as investment adviser to certain employees' securities companies within the meaning of section 2(a)(13) of the Act ("ESCs"). KECALP and MLGPE are registered as investment advisers under the Advisers Act.

4. On August 20, 2012, the United States District Court for the Western District of Washington entered the Injunction against ReconTrust, in a matter brought by the Attorney General of the State of Washington (the "AG").[2] The complaint filed by the

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[2] *State of Washington v. ReconTrust Company, N.A.* No. 2:11-cv-1460 (W.D. Wash. August 20, 2012).

AG ("Complaint")[3] alleged that ReconTrust failed to comply with the procedures of the Washington Deeds of Trust Act ("Deeds of Trust Act") in foreclosures it conducted since at least June 12, 2008. Denying any wrongdoing as alleged by the AG or otherwise, ReconTrust consented to the entry of the Injunction, which enjoined ReconTrust from doing business as a foreclosure trustee under deeds of trust with respect to property located in the State of Washington, except in certain circumstances.[4]

Applicants' Legal Analysis:

1. Section 9(a)(2) of the Act, in relevant part, prohibits a person who has been enjoined from acting as a bank, or from engaging in or continuing any conduct or practice in connection with such activity, from acting, among other things, as an investment adviser or depositor of any registered investment company, or a principal underwriter for any registered open-end investment company, registered unit investment trust ("UIT") or registered face-amount certificate company. Section 9(a)(3) of the Act extends the prohibitions of section 9(a)(2) to a company any affiliated person of which has been disqualified under the provisions of section 9(a)(2). Section 2(a)(3) of the Act defines "affiliated person" to include, among others, any person directly or indirectly controlling, controlled by, or under common control with, the other person. Applicants state that ReconTrust is, or may be considered to be, under common control with and therefore an affiliated person of each of the other Applicants. Applicants state that the entry of the Injunction may result in Applicants being subject to the disqualification provisions of

3 The Complaint was initially filed in the State of Washington King County Superior Court in a civil action and the matter was later removed to the United States Western District Court of Washington.

4 This Injunction will terminate three years after its entry. As described in the application, ReconTrust is required to take certain remedial actions to address the conduct that served as the basis for the Injunction.

section 9(a) of the Act because ReconTrust is enjoined from engaging in or continuing particular conduct or practice in connection with banking activity.[5]

2. Section 9(c) of the Act provides that the Commission shall grant an application for exemption from the disqualification provisions of section 9(a) if it is established that these provisions, as applied to Applicants, are unduly or disproportionately severe or that the Applicants' conduct has been such as not to make it against the public interest or the protection of investors to grant the exemption. Applicants have filed an application pursuant to section 9(c) seeking a temporary and permanent order exempting the Applicants and the other Covered Persons from the disqualification provisions of section 9(a) of the Act.

3. Applicants believe they meet the standard for exemption specified in section 9(c). Applicants state that the prohibitions of section 9(a) as applied to them would be unduly and disproportionately severe and that the conduct of Applicants has been such as not to make it against the public interest or the protection of investors to grant the exemption from section 9(a).

4. Applicants state that the conduct giving rise to the Injunction did not involve any of the Applicants acting in the capacity as investment adviser, sub-adviser, or principal underwriter (as defined in section 2(a)(29) of the Act) for any registered investment companies ("RIC") or ESCs (together with any business development company, "Funds"). Applicants state that to the best of their reasonable knowledge none

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[5] Applicants represent that the foreclosure trustee activity specified in the Injunction is the same as or similar to at least some of the loan servicing activity deemed banking activity by an administrative order issued by the Office of the Comptroller of the Currency. *See In the Matter of Bank of America, N.A.*, The Office of the Comptroller of the Currency Stipulation & Consent Order No. AA-EC-11-12 (Apr. 13, 2011) (the "OCC Order"). Applicants state that under the standard set forth in the OCC Order, ReconTrust is enjoined from engaging in or continuing particular conduct or practice in connection with banking activity.

of the Applicants' current directors, officers or employees who is involved in providing services as investment adviser, subadviser or depositor for any Funds or principal underwriter (as defined in section 2(a)(29) of the Act) for any registered open-end company, UIT or registered face amount certificate company (collectively, the "Fund Servicing Activities") (or any other persons in such roles during the time period covered by the Complaint) participated in the conduct alleged in the Complaint that constitutes the violations that provide a basis for the Injunction. Applicants also state that the alleged conduct giving rise to the Injunction did not involve any Fund for which an Applicant provided Fund Servicing Activities.

5. Applicants further represent that the inability of Applicants (except for ReconTrust) to continue providing Fund Servicing Activities would result in potentially severe financial hardships for both the Funds and their shareholders. Applicants state that they will distribute written materials, including an offer to meet in person to discuss the materials, to the board of directors of each Fund (excluding the ESCs), including the directors who are not "interested persons," as defined in section 2(a)(19) of the Act, of such Fund, and their independent legal counsel as defined in rule 0-1(a)(6) under the Act, if any, regarding the Injunction, any impact on the Funds, and the application. The Applicants will provide the Funds with all information concerning the Injunction and the application that is necessary for the Funds to fulfill their disclosure and other obligations under the federal securities laws.

6. Applicants also assert that, if the Applicants were barred from engaging in Fund Servicing Activities, the effect on their businesses and employees would be severe.

The Applicants state that they have committed substantial resources to establishing expertise in providing Fund Servicing Activities.

7. Applicants also state that disqualifying KECALP and MLGPE from continuing to provide investment advisory services to their ESCs is not in the public interest or in furtherance of the protection of investors and would frustrate the expectations of eligible employees who invest in the ESCs that the ESCs would be managed by an affiliate of their employer.

8. Applicants state that several Applicants and certain of their affiliates have previously received orders under section 9(c), as described in greater detail in the application.

Applicants' Condition:

Applicants agree that any order granting the requested relief will be subject to the following condition:

> Any temporary exemption granted pursuant to the application shall be without prejudice to, and shall not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings involving or against, Covered Persons, including without limitation, the consideration by the Commission of a permanent exemption from section 9(a) of the Act requested pursuant to the application, or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

Temporary Order:

The Commission has considered the matter and finds that Applicants have made the necessary showing to justify granting a temporary exemption.

Accordingly,

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that the Applicants and the other Covered Persons are granted a temporary exemption from the provisions of section 9(a), effective forthwith, solely with respect to the Injunction, subject to the condition in the application, until the date the Commission takes final action on their application for a permanent order.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67698/August 21, 2012

WHISTLEBLOWER AWARD PROCEEDING
File No. 2012-1

In the Matter of the Claim for Award

in connection with

Non-Public

Non-Public

Notice of Covered Action 2012-

## ORDER DETERMINING WHISTLEBLOWER AWARD CLAIM

On May 18, 2012, the Claims Review Staff made a Preliminary Determination related to this Whistleblower Award Proceeding (Notice of Covered Action 2012- ). The Preliminary Determination provided an award to Claimant 1 of thirty percent (30%) of the monetary sanctions collected in this covered action. No Commissioner has requested a review of this determination. As a result, pursuant to Rule 21F-10(h) under the Exchange Act, the Claims Review Staff's determination to award a payment to Claimant 1 is now final.

Accordingly, for the reasons set forth in the Preliminary Determination of the Claims Review Staff dated May 18, 2012, it is hereby ORDERED that Claimant 1 shall receive an award of thirty percent (30%) of the monetary sanctions collected in the above-referenced covered action, including any monetary sanctions collected after the date of this Order.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

[1] The Preliminary Determination of the Claims Review Staff also denied an award to Claimant 2 . That determination has not been contested. Accordingly, pursuant to Rule 21F-10(f) under the Securities Exchange Act of 1934 (the "Exchange Act"), Claimant 2 has exhausted administrative remedies and the determination to deny an award to Claimant 2 has become final.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67699/August 21, 2012

WHISTLEBLOWER AWARD PROCEEDING
File No. 2012-1

In the Matter of the Claim for Award

in connection with

Non-Public

Non-Public

Notice of Covered Action 2012-

## ORDER DETERMINING WHISTLEBLOWER AWARD CLAIM

On May 18, 2012, the Claims Review Staff made a Preliminary Determination related to this Whistleblower Award Proceeding (Notice of Covered Action 2012- ). The Preliminary Determination determined that the Commission should deny an award to Claimant . Claimant did not file a response to the Preliminary Determination. As a result, pursuant to Rule 21F-10(f), the Claims Review Staff's determination to deny Claimant claim for an award became final on July 18, 2012.

Accordingly, for the reasons set forth in the Preliminary Determination of the Claims Review Staff dated May 18, 2012, it is hereby ORDERED that Claimant be denied an award in the above-referenced covered action.

By the Commission.

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67710 / August 22, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14994

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| In the Matter of<br><br>Feigeda Electronic Technology, Inc. (f/k/a SRKP 20, Inc.),<br>FirstQuote, Inc. (f/k/a Fine Line Properties, Inc.),<br>Flexemessaging.com, Inc. (n/k/a Flexemessaging Acquisition Ltd.),<br>Flomo Resources, Inc.,<br>Formulab Neuronetics Corp. Ltd. (n/k/a Foundation Healthcare Ltd.), and<br>Genesis Development & Construction Ltd.,<br><br>Respondents. | ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934 |

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Feigeda Electronic Technology, Inc. (f/k/a SRKP 20, Inc.), FirstQuote, Inc. (f/k/a Fine Line Properties, Inc.), Flexemessaging.com, Inc. (n/k/a Flexemessaging Acquisition Ltd.), Flomo Resources, Inc., Formulab Neuronetics Corp. Ltd. (n/k/a Foundation Healthcare Ltd.), and Genesis Development & Construction Ltd.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Feigeda Electronic Technology, Inc. (f/k/a SRKP 20, Inc.) (CIK No. 1421527) is a Delaware corporation located in Shenzhen City, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Feigeda Electronic Technology is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2010, which reported a net loss of over $7,000 for the prior three months.

2. FirstQuote, Inc. (f/k/a Fine Line Properties, Inc.) (CIK No. 1021734) is a void Delaware corporation located in Geneva, Switzerland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FirstQuote is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported a net loss of over $7.7 million for the prior nine months.

3. Flexemessaging.com, Inc. (n/k/a Flexemessaging Acquisition Ltd.) (CIK No. 1093071) is an Idaho corporation located in Sydney, Australia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Flexemessaging.com is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2001.

4. Flomo Resources, Inc. (CIK No. 1373855) is a revoked Nevada corporation located in Panama City, Panama with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Flomo Resources is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of over $5,000 for the prior three months.

5. Formulab Neuronetics Corp. Ltd. (n/k/a Foundation Healthcare Ltd.) (CIK No. 1023845) is a New South Wales company located in Leederville, Western Australia, Australia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Formulab Neuronetics is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended June 30, 1998, which reported a net loss of over $17 million (Australian) for the prior twelve months.

6. Genesis Development & Construction Ltd. (CIK No. 1028572) is an Israeli company located in Haifa, Israel with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Genesis Development & Construction is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F/A for the period ended December 31, 1998.

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to

them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

9. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

**III.**

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

**IV.**

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

**ÉTATS-UNIS D'AMÉRIQUE**
**Devant la**
**SECURITIES AND EXCHANGE COMMISSION**
**(COMMISSION DES OPERATIONS DE BOURSE)**

**LOI SUR LES OPERATIONS DE BOURSE DE 1934**
**Sortie N° 67710 / August 22, 2012**

**PROCÉDURE ADMINISTRATIVE**
**Dossier N° 3-14994**

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| **Affaire**<br><br>**Feigeda Electronic Technology, Inc. (anciennement SRKP 20, Inc.),**<br>**FirstQuote, Inc. (anciennement Fine Line Properties, Inc.),**<br>**Flexemessaging.com, Inc. (aujourd'hui Flexemessaging Acquisition Ltd.),**<br>**Flomo Resources, Inc.,**<br>**Formulab Neuronetics Corp. Ltd. (aujourd'hui Foundation Healthcare Ltd.), et**<br>**Genesis Development & Construction Ltd.,**<br><br>**Défendeurs.** | **ORDONNANCE INSTITUANT UNE PROCEDURE ADMINISTRATIVE ET UN AVIS D'AUDIENCE EN VERTU DE L'ARTICLE 12 (j) DE LA LOI SUR LES OPERATIONS DE BOURSE DE 1934** |

**I.**

La Securities and Exchange Commission (Commission des Opérations de Bourse) (« la Commission ») juge nécessaire et approprié pour la protection des investisseurs que des procédures administratives publiques soient et, par les présentes sont, instituées conformément à l'article 12(j) de la Loi sur les Opérations de Bourse de 1934 (« la Loi sur la Bourse » ) contre les défendeurs Feigeda Electronic Technology, Inc. (anciennement SRKP 20, Inc.), FirstQuote, Inc. (anciennement Fine Line Properties, Inc.), Flexemessaging.com, Inc. (aujourd'hui Flexemessaging Acquisition Ltd.), Flomo Ressources, Inc., Formulab Neuronetics Corp. Ltd. (aujourd'hui Foundation Healthcare Ltd.), et Genesis Development & Construction Ltd.

**II.**

Après enquête, la Division de l'Application de la Loi affirme que :

A. DÉFENDEURS

1. Feigeda Electronic Technology, Inc. (anciennement SRKP 20, Inc.) (n° 1421527 CIK) est une société du Delaware située à Shenzhen, en Chine, avec une catégorie de titres inscrits auprès de la Commission conformément à l'article 12(g) de la Loi sur la Bourse. Feigeda Electronic Technology est en retard dans le dépôt périodique de ses documents auprès de la Commission, n'ayant déposé aucun rapport périodique depuis le formulaire 10-Q pour la période venant à échéance le 30 septembre 2010, qui indiquait une perte nette de plus de 7 000 USD pour les trois mois précédents.

2. FirstQuote, Inc. (anciennement Fine Line Properties, Inc.) (n° 1021734 CIK) est une société écran du Delaware située à Genève, en Suisse, avec une catégorie de titres inscrits auprès de la Commission conformément à l'article 12 (g) de la Loi sur la Bourse. FirstQuote est en retard dans le dépôt périodique de ses documents auprès de la Commission, n'ayant déposé aucun rapport périodique depuis le formulaire 10-QSB pour la période venant à échéance le 30 septembre 2000, qui indiquait une perte nette de plus de 7,7 millions USD pour les neuf mois précédents.

3. Flexemessaging.com, Inc. (aujourd'hui Flexemessaging Acquisition Ltd.) (n° 1093071 CIK) est une société de l'état d'Idaho située à Sydney, en Australie, avec une catégorie de titres inscrits auprès de la Commission conformément à l'article 12(g) de la Loi sur la Bourse. Flexemessaging.com est en retard dans le dépôt périodique de ses documents auprès de la Commission, n'ayant déposé aucun rapport périodique depuis le formulaire 10-QSB pour la période venant à échéance le 31 mars 2001.

4. Flomo Resources, Inc. (n° 1373855 CIK) est une société radiée du Nevada situé à Panama City, au Panama avec une catégorie de titres inscrits auprès de la Commission conformément à l'article 12(g) de la Loi sur la Bourse. Flomo Resources est en retard dans le dépôt périodique de ses documents auprès de la Commission, n'ayant déposé aucun rapport périodique depuis le formulaire 10-Q pour la période venant à échéance le 30 septembre 2008, qui indiquait une perte nette de plus de 5 000 USD pour les trois mois précédents.

5. Formulab Neuronetics Corp. Ltd. (aujourd'hui Foundation Healthcare Ltd.) (n° 1023845 CIK) est une société de Nouvelle-Galles du Sud située à Leederville, Australie Occidentale, en Australie, avec une catégorie de titres inscrits auprès de la Commission conformément à l'article 12 (g) de la Loi sur la Bourse. Formulab Neuronetics est en retard dans le dépôt périodique de ses documents auprès de la Commission, n'ayant déposé aucun rapport périodique depuis le formulaire 20-F pour la période venant à échéance le 30 juin 1998, qui indiquait une perte nette de plus de 17 millions AUSD pour les douze mois précédents.

6. Genesis Development & Construction Ltd. (n° 1028572 CIK) est une société israélienne située à Haïfa, en Israël avec une classe de titres inscrits auprès de la Commission conformément à l'article 12(g) de la Loi sur la Bourse. Genesis Development & Construction est en retard dans le dépôt périodique de ses documents auprès de la Commission, n'ayant déposé aucun rapport périodique depuis le formulaire 20-F/A pour la période venant à échéance le 31 décembre 1998.

B. DÉPOTS PÉRIODIQUES DÉFAILLANTS

7. Ainsi qu'il est mentionné plus en détail ci-dessus, tous les défendeurs sont en retard dans le dépôt périodique de leurs documents auprès de la Commission, ont omis à plusieurs reprises de répondre à leurs obligations de déposer en temps opportun ces rapports périodiques et ont omis de tenir compte des lettres de relance envoyées par la Division des Finances des Sociétés, demandant leur mise en conformité avec leurs obligations de dépôt périodiques ou, du fait de leur

incapacité à maintenir une adresse valide dans le dossier déposé à la Commission, conformément aux règles de la Commission, n'ont pas reçu les dites lettres.

8. L'article 13(a) de la Loi sur la Bourse et les règles promulguées qui en découlent imposent aux émetteurs de titres inscrits en vertu de l'article 12 de la Loi sur la Bourse de déposer auprès de la Commission des informations actuelles et précises dans les rapports périodiques, même si l'enregistrement est volontaire en vertu de l'article 12(g). Plus précisément, la règle 13a-1 exige que les émetteurs déposent des rapports annuels et la règle 13a-13 exige que les émetteurs nationaux déposent des rapports trimestriels.

9. En conséquence de ce qui précède, les défendeurs ont omis de se conformer aux dispositions de l'article 13(a) de la Loi sur la Bourse et des règles 13a-1 et 13a-13 qui en découlent.

## III.

Compte tenu des allégations formulées par la Division de l'Application de la Loi, la Commission juge nécessaire et approprié pour la protection des investisseurs que les procédures administratives publiques soient engagées pour déterminer :

A. Si les allégations contenues dans la section II ci-dessus sont vraies et, à cet effet, donner aux répondants la possibilité d'établir des moyens de défense contre ces allégations et,

B. S'il est nécessaire et approprié pour la protection des investisseurs de suspendre pour une période n'excédant pas douze mois, ou de révoquer l'enregistrement de chaque catégorie de titres inscrits en vertu de l'article 12 de la Loi sur la Bourse et appartenant aux défendeurs identifiés dans la section II ci-dessus et tout successeur en vertu des règles 12b-2 ou 12g-3 de la Loi sur la Bourse et toutes nouvelles dénominations sociales des défendeurs.

## IV.

IL EST ICI ORDONNÉ qu'une audience publique dans le but de recueillir des témoignages sur les questions énoncées à la section III des présentes soit convoquée à un moment et un lieu qui seront fixés et devant un juge de droit administratif qui sera désigné par ordonnance, tel qu'il est prévu par l'article 110 du Règlement de Procédure de la Commission [17 CFR § 201.110].

IL EST EN OUTRE ICI ORDONNÉ que les défendeurs devront apporter une réponse aux allégations contenues dans la présente ordonnance dans les dix (10) jours suivant la signification de la présente ordonnance, comme le prévoit la règle 220(b) du Règlement de Procédure de la Commission [17 CFR § 201.220(b)].

Si les défendeurs ne parviennent pas à apporter les réponses exigées ou ne parviennent pas à comparaître à une audience après avoir été dûment notifiés, les défendeurs, ainsi que tout successeur en vertu des règles 12b-2 ou 12g-3 de la Loi sur la Bourse et leurs nouvelles dénominations sociales, pourront être considérés en tort et la procédure pourra être déterminée contre eux lors de l'examen de la présente ordonnance, les allégations en résultant pouvant être considérées comme véridiques, ainsi qu'il est prévu aux règles 155(a), 220(f), 221(f), et 310 du Règlement de Procédure de la Commission [17 CFR § § 201.155(a), 201.220(f), 201.221(f), et 201.310].

La présente ordonnance doit être immédiatement signifiée aux défendeurs personnellement ou par courrier certifié, recommandé ou express ou par tout autre moyen autorisé par le Règlement de Procédure de la Commission.

IL EST EN OUTRE ORDONNÉ que le juge de droit administratif rendra une première décision au plus tard 120 jours à compter de la date de signification de la présente ordonnance, conformément à l'article 360(a)(2) du Règlement de Procédure de la Commission [17 CFR § 201.360(a)(2)].

En l'absence d'une dérogation appropriée, aucun dirigeant ou employé de la Commission agissant dans le cadre de ses fonctions d'enquête ou de poursuites dans cet État ou de toute procédure liée aux faits ne sera autorisé à participer ou à fournir des conseils dans le cadre de la décision relative à cette affaire, sauf en tant que témoin ou conseil dans une procédure tenue conformément à l'avis. Comme cette procédure ne constitue pas une « élaboration de règles » au sens de l'article 551 de la Loi sur la Procédure Administrative, elle n'est pas considérée comme étant soumise aux dispositions de l'article 553 retardant la date effective de toute action finale de la Commission.

Par la Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secrétaire

Commissioner Aguilar
Commissioner Gallagher
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67709 / August 22, 2012**

**INVESTMENT ADVISERS ACT OF 1940**
**Release No. 3448 / August 22, 2012**

**INVESTMENT COMPANY ACT OF 1940**
**Release No. 30179 / August 22, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14993**

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| **In the Matter of**<br><br>**MIDDLECOVE CAPITAL, LLC, AND NOAH L. MYERS,**<br><br>**Respondents.** | **ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940** |

**I.**

The United States Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against MiddleCove Capital, LLC ("MiddleCove") and Noah L. Myers ("Myers") (collectively, "the Respondents").

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. SUMMARY**

1. From approximately October 2008 to February 2011 (the "relevant period"), Noah L. Myers, the sole owner of MiddleCove Capital, LLC, engaged in fraudulent trade allocation – "cherry-picking" – at MiddleCove. During the relevant period, MiddleCove was a registered investment adviser. Myers executed his cherry-picking scheme by unfairly allocating trades that had appreciated in value during the course of the day to his personal and business accounts and allocating trades that had depreciated in value during the day to the accounts of his

purchase, Myers would often sell the security and disproportionately allocate the purchase and the realized day-trading profit to his own accounts or accounts benefiting himself or his family members. In contrast, for securities that did not appreciate on the day of purchase, Myers would disproportionately allocate these purchases to his clients' accounts and his clients would hold the position for more than one day. Myers carried out his cherry-picking scheme with regard to several securities, but was most active with an inverse and leveraged exchange traded fund (ETF). Myers finally ceased these practices in February 2011 when one of his employees threatened to contact the Commission. As a result of his fraud, Myers realized ill-gotten gains of approximately $460,000. Myers's cherry-picking scheme also resulted in more than $2 million in client losses from his trading in the inverse and leveraged ETF. Neither MiddleCove nor Myers disclosed to clients that they were engaged in cherry-picking and that they would favor Myers's accounts in the allocation of appreciated securities. In addition, Myers and MiddleCove failed to follow the policies stated in MiddleCove's ADV concerning trade allocation.

2. By virtue of their conduct, the Respondents willfully violated Section 10(b) of the Exchange Act [15 U.S.C. §§78j(b)] and Rule 10b-5 [17 C.F.R. §§240.10b-5] promulgated thereunder, and Sections 206(1) [15 U.S.C. §80b-6(1)], 206(2) [15 U.S.C. §80b-6(2)] and 207 [15 U.S.C. §80b-7] of the Advisers Act.

## B. RESPONDENTS

3. **MiddleCove Capital, LLC** (SEC File No. 801-68677), is a Connecticut limited liability company with its principal place of business in Centerbrook, Connecticut. It has been registered with the Commission as an investment adviser since 2008 when Myers formed MiddleCove. At its peak in 2011, when MiddleCove had two portfolio managers including Myers, MiddleCove managed approximately $129 million in client assets. MiddleCove is wholly owned and controlled by Myers. In mid-2011, one of MiddleCove's portfolio managers left the firm after being there for approximately one year. As a result of his departure, MiddleCove's assets under management declined by approximately one-half. MiddleCove currently has no employees other than Myers. As of September 31, 2011, MiddleCove managed approximately 350 client accounts and had approximately $53,000,000 under management. MiddleCove's clients are individuals and families.

4. **Noah L. Myers**, age 40, resides in Old Lyme, Connecticut. Myers is the principal, chief investment officer, and sole owner of MiddleCove. Myers formed MiddleCove in early 2008 after an eleven-year career at Citigroup Global Markets Inc. ("Citigroup"). During the relevant time period, Myers was also a registered representative of Purshe Kaplan Sterling Investments, Inc. ("Purshe Kaplan"), a registered broker-dealer located in Albany, New York. Myers asserted his privilege against self-incrimination when he testified in the investigation.

## C. OTHER RELEVANT ENTITY

5. **Purshe Kaplan Sterling Investments, Inc.** (SEC File No. 8-46844), is a New York corporation with its principal place of business in Albany, New York. Purshe Kaplan has been registered with the Commission as a broker-dealer since 1994. Myers was a registered representative of Purshe Kaplan during the relevant time period.

## D. RESPONDENTS' CONDUCT

**The cherry-picking scheme.**

6. Myers formed MiddleCove in February 2008, and, in April 2008, Myers began using an omnibus account ("master account") at Charles Schwab & Co., Inc. ("Charles Schwab"), the custodian for all of MiddleCove's accounts, to place orders for his personal and client transactions. When he used the master account to purchase securities, Myers would place a block trade in the master account and then allocate the shares to his personal and client accounts.

7. Prior to October 2008, Myers was relatively inactive in his own accounts as compared to his client accounts. However, Myers began day-trading his own accounts in October 2008 and actively traded his own accounts over the next two years. From October 2008 to February 2011, Myers allocated approximately $60 million in securities purchased in the master account to his personal and business accounts, compared to approximately $200 million in securities purchased in the master account and allocated to MiddleCove's clients. Myers's personal trading activity, including his day-trading, slowed considerably after a MiddleCove employee confronted Myers in late 2010 about his cherry-picking scheme.

8. From October 2008 to February 2011, Myers engaged in a cherry-picking scheme to misappropriate profitable transactions to his personal and business accounts. Myers made block purchases of securities in the master account sometime during the trading day before the 4 P.M. close of the U.S. stock market. After making a purchase, Myers delayed allocating it until he knew whether there was a gain or loss on the trade on the day of purchase. During the relevant time period, approximately 65% of the purchases that Myers allocated to his clients were not allocated until after 4 P.M. on the day of the purchase. On some occasions, Myers would even wait until the next day to allocate a purchase and then mark the allocated trade "As Of" the day it was purchased in the market. This timing difference made it possible for Myers to selectively allocate profitable trades to his own accounts. If the security increased in price on the day of purchase, Myers would often sell the security on the same day he purchased it (a "day trade") and disproportionately allocate the day-trade profit to his personal and business accounts. However, if the security's price did not increase on the day of purchase, Myers disproportionately allocated the purchase to his clients' accounts.

9. Myers's scheme often involved purchasing a security in the master account for consecutive days over several weeks, or even months, and then allocating the security depending on its performance. If it increased in value on the day of purchase, he disproportionately allocated the security to his own accounts. If the security decreased in value on the day of purchase, Myers disproportionately allocated it to his clients' accounts. Thus, the securities on which Myers was disproportionately making money were the same securities on which his clients were disproportionately losing money. In fact, during the relevant time period, when Myers allocated a trade to his own accounts, he had almost always allocated the same security to his clients' accounts on a different trading day within one month of the allocation to his own accounts. The only consistent difference in whether Myers allocated a security to his own

accounts or his clients' accounts was whether the security appreciated in value on the day it was purchased.

**The scheme is identified.**

10. Charles Schwab had an internal program that flagged Myers's accounts as potentially receiving favorable allocation of profitable day trades. A MiddleCove employee investigated Myers's trading patterns after he received a call from an employee of Charles Schwab in November 2010. The Schwab employee indicated that Schwab had flagged the allocation of MiddleCove's block trades as potentially giving profitable trades to an account that benefited Myers. As a result of the call, the MiddleCove employee analyzed Myers's trade allocation for a stock (Research in Motion or RIMM) and a leveraged ETF (ProShares UltraShort Financials or SKF). From his analysis of Myers's trade allocation of these two securities, the employee suspected that Myers was cherry-picking trades in favor of his own account at the expense of his clients. Specifically, the employee believed, based on his review of Myers's trade allocation, that Myers was allocating trades that lost money at the end of the day to clients instead of himself and that the performance for Myers's accounts was much more profitable than his clients' accounts.

11. Following the MiddleCove employee's analysis of Myers's cherry-picking scheme, all four of MiddleCove's employees confronted Myers about his trade allocation in mid-December 2010. As a result of the confrontation, Myers agreed to use a trading method that required Myers to place all of his client trades through a certain Charles Schwab trade application, and to use a different method for his own trades.

12. On February 18, 2011, the same MiddleCove employee who had analyzed Myers's trading in November noticed Myers had allocated a day trade profit to himself using the Charles Schwab trade application that Myers had agreed to only use for clients' trades. The employee confronted Myers and threatened to report Myers to the Commission if he did not re-allocate the trade. Myers agreed to re-allocate the trade to a client. After this confrontation, Myers stopped cherry-picking and did relatively little trading in his own accounts.

13. Commission examination staff interviewed Myers in November 2011 about his own securities trading. Myers admitted that he had a day-trading strategy in one of his personal accounts that was profitable about 95% of the time, but he did not offer a plausible explanation for his stellar day-trading performance.

**Myers profited at his clients' expense.**

14. During the relevant time period, trades that Myers made in his own accounts increased in value by an average of approximately 67 basis points (or .67 of one-percent) on the day that Myers purchased the security. This 67 basis-point increase resulted in approximately $408,000 in first-day profits for Myers's own accounts. In contrast, during the relevant time period, trades that Myers allocated to his clients' accounts *decreased* by approximately 32 basis points on the day that Myers purchased the security. This difference in return is highly statistically significant – the likelihood of Myers experiencing his first-day return (approximately 67 basis points) compared to the average first-day return for all of his and his clients' purchases

(approximately negative 32 basis points) from a "lucky" allocation of trades is less than one in ten million. Similarly, approximately 74% of Myers's trades had a profit on the first day compared to approximately 52% of his clients' trades – the likelihood of observing a difference in profitably this large by chance is less than one in one trillion.

15. Myers realized approximately $138,000 in profits on his trades of SKF (the leveraged and inverse ETF discussed above) while his clients realized a net loss of approximately $2.2 million on their SKF trades. These losses were spread out among approximately 120 clients.

16. Myers's cherry-picking scheme also resulted in significant investment losses for MiddleCove clients to whom Myers allocated shares of SKF. Many of the clients did not know what SKF was or that they had invested in a leveraged ETF, even when their investment in SKF was a significant part of their account value and they experienced significant losses because of it. Many of these clients were retired and/or were using their MiddleCove account as their source of funds for retirement and had limited willingness or ability to accept significant investment risk.

17. Leveraged and inverse ETFs like SKF are generally not designed to be held for more than one day. In June 2009, FINRA issued Notice to Members 09-31 reminding firms of their sales practice obligations relating to leveraged and inverse ETFs. SKF is a leveraged and inverse ETF designed to achieve daily investment results corresponding to twice the inverse (opposite) of the daily performance of the Dow Jones U.S. Financials Index. The FINRA notice described how leveraged and inverse ETFs are designed to achieve their stated objectives on a daily basis, and, "[d]ue to the effect of compounding, their performance over longer periods of time can differ significantly from the performance (or inverse of the performance) of the underlying index or benchmark during the same period of time. . . This effect can be magnified in volatile markets." With an inverse or a leveraged ETF, if the relevant benchmark moves 100 points in one direction on day one and returns to the original level on day two, an investment in the ETF held for both days will be negative even though the benchmark is flat. (If, on the other hand, the benchmark moved in the same direction on both days, an investor in the ETF would have even better performance than shorting the index or investing in the index on margin.) If the ETF is an inverse and leveraged ETF, as is the case with SKF, the loss would be more significant. For these and other reasons, the FINRA notice concluded that "While the customer-specific suitability analysis depends on the investor's particular circumstances, inverse and leveraged ETFs typically are not suitable for retail investors who plan to hold them for more than one trading session, particularly in volatile markets."

18. During the period of his cherry-picking scheme, approximately one-third of Myers's one-day profits were from SKF trades. These profits came at the expense of approximately $2 million in client losses because Myers exposed his clients to the downside of this volatile security so that he could reap the rewards when SKF rose in value on the day of purchase. This scheme meant that Myers held SKF for more than one day in the accounts of several clients for whom such an investment was inappropriate. Moreover, at times, SKF was a considerable proportion of the holdings of his clients, further magnifying their investment risk. For example, Myers's decision to use SKF as his tool for his cherry-picking scheme extended to:

- Investor A, age 84 and retired, invested all of her savings with MiddleCove. She described herself as conservative investor. Nonetheless, in September 2009, Myers established an $89,727.74 SKF position for this investor, which was 34.3% of her month-end account balance. The investor lost a net of $14,543 on SKF, and she had no idea what this security was.

- Investor B, age 77 and retired, had his retirement savings completely with MiddleCove. He viewed himself as "moderate risk" investor. In September 2009, Myers established a $251,196.95 SKF position for this investor in his only account, representing about 28% of the account. The investor lost a net of $59,483 on SKF.

- Investor C, age 70 and retired, was a client who described himself as unsophisticated. In September 2009, Investor C had approximately $239,288.89 of SKF, or approximately 87.7% of the account's month end value. The investor had no knowledge of what SKF was, and he lost a net of $83,264 on SKF.

**The scheme was contrary to MiddleCove's Form ADV.**

19. During the relevant time period, MiddleCove filed its Form ADV, Part II on April 29, 2009, and March 29, 2010. Items 12A, 12B, and 13A of the Form ADV, Part II stated, in pertinent part:

> Transactions for each client generally will be effected independently, unless the Adviser decides to purchase or sell the same securities for several clients at approximately the same time. The Adviser may (but is not obligated to) combine or "batch" such orders to obtain best execution, to negotiate more favorable commission rates, or to allocate equitably among the Adviser's clients differences in prices and commissions or other transaction costs that might have been obtained had such orders been placed independently. Under this procedure, transactions will generally be averaged as to price and allocated among the Adviser's clients pro rata to the purchase and sale orders placed for each client on any given day. To the extent that the Adviser determines to aggregate client orders for the purchase or sale of securities, including securities in which the Adviser's Advisory Affiliate(s) may invest, the Adviser shall generally do so in accordance with applicable rules promulgated under the Advisers Act and no-action guidance provided by the staff of the U.S. Securities and Exchange Commission. The Adviser shall not receive any additional compensation or remuneration as a result of the aggregation.

The same items in the ADV went on to list specific circumstances in which allocations may not be *pro rata* among accounts. These statements, taken as a whole, were misleading because the statements conveyed the impression that batched trades would be allocated fairly and not unduly favor Myers or MiddleCove, and, when trades included securities in which the "Adviser's Advisory Affiliate(s) may invest," there would be extra layer of protection provided by a regulatory framework.

## E. VIOLATIONS

20. By knowingly or recklessly allocating profitable trades to Myers's personal and business accounts at the expense of advisory clients, Myers and MiddleCove willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities. In addition, through this cherry-picking scheme and by failing to disclose the scheme, Myers and MiddleCove willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser with respect to advisory clients or prospective clients.

21. During the relevant period, MiddleCove filed misleading Forms ADV that willfully made material misstatements concerning MiddleCove's trade allocation policies and procedures. Therefore, MiddleCove willfully violated Section 207 of the Advisers Act. By signing and causing to be filed on behalf of MiddleCove these misleading Forms ADV, Myers also willfully violated Section 207 of the Advisers Act.

## III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate and in the public interest that administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Sections 203(e) and 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act; and

E. Whether, pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1), 206(2), and 207 of the Advisers Act, whether Respondents should be ordered to pay a civil penalty pursuant to Section 21B(a) of the Exchange Act and Section 203(i) of the Advisers Act, and whether Respondents should be ordered to pay disgorgement pursuant to Sections 21B(e) and 21C(e) of the Exchange Act and Section 203 of the Advisers Act.

## IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall each file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If either of the Respondents fail to file the directed answer, or fails to appear at a hearing after being duly notified, that Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67708 / August 22, 2012**

**ACCOUNTING AND AUDITING ENFORCEMENT**
**Release No. 3402 / August 22, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14992**

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| **In the Matter of**<br><br>**Todd C. Crow,**<br><br>**Respondent.** | **ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS** |

## I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Todd C. Crow ("Respondent" or "Crow") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

## II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Crow, age 64, was the chief financial officer of NutraCea, Inc. ("NutraCea") from October 2005 to May 2008 and July 2008 to November 2008.

2. NutraCea is a California corporation with its principal executive offices located in Scottsdale, Arizona and is engaged in the business of manufacturing health food products. NutraCea's common stock is registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and trades on the OTC:BB under the symbol "NTRZ".

3. On January 13, 2011, the Commission filed a complaint against Crow in SEC v. NutraCea, et al. (Civil Action No. CV 11-0092-PHX-SRB), in the United States District Court for the District of Arizona. On July 23, 2012, the court entered a final judgment permanently enjoining Crow, by consent, from future violations of Section 17(a) of the Securities Act of 1933, Sections 10(b) and 13(b)(5) of the Exchange Act, and Rules 10b-5, 13a-14, 13b2-1, and 13b2-2 thereunder, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder. The final judgment also prohibits Crow from serving as an officer or director of a public company and orders him to pay a $50,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that NutraCea, through the misconduct of Crow and others, overstated its sales revenues for its fiscal year 2007 by engaging in improper revenue recognition practices. The complaint alleged that Crow violated the antifraud, books and records, and internal controls provisions of the federal securities laws because he knew or was reckless in not knowing that NutraCea improperly accounted for a $2.6 million sale in the second quarter of 2007 and a $1.9 million sale in the fourth quarter of 2007. The complaint further alleged that Crow signed false management representation letters to NutraCea's auditors.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Crow's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that Crow is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Paredes,
Commissioner Gallagher
Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 240 and 249b

[34-67716; S7-40-10]

RIN 3235-AK84

CONFLICT MINERALS

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting a new form and rule pursuant to Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to the use of conflict minerals. Section 1502 added Section 13(p) to the Securities Exchange Act of 1934, which requires the Commission to promulgate rules requiring issuers with conflict minerals that are necessary to the functionality or production of a product manufactured by such person to disclose annually whether any of those minerals originated in the Democratic Republic of the Congo or an adjoining country. If an issuer's conflict minerals originated in those countries, Section 13(p) requires the issuer to submit a report to the Commission that includes a description of the measures it took to exercise due diligence on the conflict minerals' source and chain of custody. The measures taken to exercise due diligence must include an independent private sector audit of the report that is conducted in accordance with standards established by the Comptroller General of the United States. Section 13(p) also requires the issuer submitting the report to identify the auditor and to certify the audit. In addition, Section 13(p) requires the report to include a description of the products manufactured or contracted to be manufactured that are not "DRC conflict free," the facilities used to process the conflict minerals, the country of

origin of the conflict minerals, and the efforts to determine the mine or location of origin. Section 13(p) requires the information disclosed by the issuer to be available to the public on its Internet website.

**DATES:**

**Effective Date:** [60 days after publication in the Federal Register]

**Compliance Date:** Issuers must comply with the final rule for the calendar year beginning January 1, 2013 with the first reports due May 31, 2014.

**FOR FURTHER INFORMATION CONTACT:** John Fieldsend, Special Counsel in the Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, 100 F Street, NE, Washington, DC 20549-3628.

**SUPPLEMENTARY INFORMATION:** We are adopting new Rule 13p-1[1] and new Form SD[2] under the Securities Exchange Act of 1934 ("Exchange Act").[3]

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[3] 15 U.S.C. 78a et seq.

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## I. BACKGROUND AND SUMMARY

### A. Statutory Provision

On December 15, 2010, we proposed a number of amendments to our rules[4] to implement the requirements of Section 1502 ("Conflict Minerals Statutory Provision") of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Act"),[5] relating to new disclosure and reporting obligations by issuers concerning "conflict minerals"[6] that originated in the Democratic Republic of the Congo ("DRC") or an adjoining country[7] (together with the DRC, the "Covered Countries").[8] Section 1502 amended the Exchange Act by adding new Section 13(p).[9] New Exchange Act Section 13(p) requires us to promulgate disclosure and reporting regulations regarding the use of conflict minerals

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[4] Conflict Minerals, Release No. 34-63547 (Dec. 15, 2010) [75 FR 80948] (the "Proposing Release").

[5] Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010).

[6] The term "conflict mineral" is defined in Section 1502(e)(4) of the Act as (A) columbite-tantalite, also known as coltan (the metal ore from which tantalum is extracted); cassiterite (the metal ore from which tin is extracted); gold; wolframite (the metal ore from which tungsten is extracted); or their derivatives; or (B) 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.

[7] The term "adjoining country" is defined in Section 1502(e)(1) of the Act as a country that shares an internationally recognized border with the DRC, which presently includes Angola, Burundi, Central African Republic, the Republic of the Congo, Rwanda, South Sudan, Tanzania, Uganda, and Zambia.

[8] In the Proposing Release, we referred to the DRC and its adjoining countries as the "DRC Countries." In this release, we use the term "Covered Countries" instead. Both terms have the same meaning. For consistency within this release, there are instances when we refer to the text of the Proposing Release and use the term "Covered Countries" instead of "DRC Countries," which was used in the Proposing Release.

[9] 15 U.S.C. 78m(p).

from the Covered Countries.[10]

As reflected in the title of Section 1502(a), which states the "Sense of the Congress on Exploitation and Trade of Conflict Minerals Originating in the Democratic Republic of the Congo," in enacting the Conflict Minerals Statutory Provision, Congress intended to further the humanitarian goal of ending the extremely violent conflict in the DRC, which has been partially financed by the exploitation and trade of conflict minerals originating in the DRC. This section explains that the exploitation and trade of conflict minerals by armed groups is helping to finance the conflict and that the emergency humanitarian crisis in the region warrants the disclosure requirements established by Exchange Act Section 13(p).[11]

Similarly, the legislative history surrounding the Conflict Minerals Statutory Provision, and earlier legislation addressing the trade in conflict minerals, reflects Congress's motivation to help end the human rights abuses in the DRC caused by the conflict.[12] Other parts of the Conflict Minerals Statutory Provision also point to the fact

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[10] See Exchange Act Section 13(p)(1)(A). This Exchange Act Section requires that the Commission promulgate rules no later than 270 days after the date of enactment.

[11] See Section 1502(a) of the Act ("It is the sense of the Congress that the exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation therein, warranting the provisions of section 13(p) of the Securities Exchange Act of 1934, as added by subsection (b).").

[12] The Congo conflict has been an issue raised in the United States Congress for a number of years. For example, in the 109th Congress, then-Senator Sam Brownback, along with Senator Richard J. Durbin and then-Senator Barack Obama, among others, co-sponsored S. 2125, the Democratic Republic of Congo Relief, Security, and Democracy Promotion Act of 2006. See Pub. L. 109-456 (Dec. 22, 2006) (stating that the National Security Strategy of the United States, dated September 17, 2002, concludes that disease, war, and desperate poverty in Africa threatens the United States' core value of preserving human dignity and threatens the United States' strategic priority of combating global terror). The legislation committed the United States to work toward peace, prosperity, and good governance in the Congo. As another example, in the 110th Congress, then-Senator Brownback and Senator Durbin introduced S. 3058, the Conflict Coltan and Cassiterite Act, which would have prohibited the importation of certain products containing

that Congress intended to promote peace and security.[13] For example, the Conflict Minerals Statutory Provision states that once armed groups no longer continue to be directly involved and benefiting from commercial activity involving conflict minerals, the President may take action to terminate the provision.[14] To accomplish the goal of helping end the human rights abuses in the DRC caused by the conflict, Congress chose to use the securities laws disclosure requirements to bring greater public awareness of the source of issuers' conflict minerals and to promote the exercise of due diligence on conflict mineral supply chains. By doing so, we understand Congress's main purpose to have been to attempt to inhibit the ability of armed groups in the Covered Countries to fund their activities by exploiting the trade in conflict minerals. Reducing the use of such conflict minerals is intended to help reduce funding for the armed groups contributing to the conflict and thereby put pressure on such groups to end the conflict. The

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columbite-tantalite or cassiterite that was mined or extracted in the DRC by groups that committed serious human rights and other violations. See S. 3058, 110th Cong. (2008). As a further example, in the 111th Congress, then-Senator Brownback introduced S. 891, the Congo Conflict Minerals Act of 2009. See S. 891, 111th Cong. (2009). This bill would have required U.S.-registered companies selling products using conflict minerals to disclose annually to the Commission the country of origin of these minerals and, if the country of origin was one of the Covered Countries, to disclose the mine of origin. Additionally, later in the 111th Congress, then-Senator Brownback sponsored S.A. 2707, which was similar to S. 891. See S.A. 2707, 111th Cong. (2009). We note also that the Democratic Republic of Congo Relief, Security, and Democracy Promotion Act of 2006 states that the National Security Strategy of the United States, dated September 17, 2002, concludes that disease, war, and desperate poverty in Africa threatens the United States' core value of preserving human dignity and threatens the United States' strategic priority of combating global terror. See Pub. L. 109-456 (Dec. 22, 2006). See also U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-763, CONFLICT MINERALS DISCLOSURE RULE: SEC'S ACTIONS AND STAKEHOLDER-DEVELOPED INITIATIVES (Jul. 2012) (discussing the Democratic Republic of Congo Relief, Security, and Democracy Promotion Act of 2006), available at http://www.gao.gov/products/GAO-12-763.

[13] See Section 1502(d)(2)(A) of the Act (stating that two years after enactment of the Act and annually thereafter, "the Comptroller General of the United States shall submit to the appropriate congressional committees a report that includes" an "assessment of the effectiveness" of the Conflict Minerals Statutory Provision "in promoting peace and security" in the Covered Countries).

[14] See Exchange Act Section 13(p)(4) (stating that the provision "shall terminate on the date on which the President determines and certifies to the appropriate congressional committees…that no armed groups continue to be directly involved and benefitting from commercial activity involving conflict minerals").

Congressional object is to promote peace and security in the Covered Countries.[15]

Congress chose to use the securities laws disclosure requirements to accomplish its goals. In addition, one of the co-sponsors of the provision noted in a floor statement that the provision will "enhance transparency" and "also help American consumers and investors make more informed decisions."[16] Also, as discussed throughout the release, a number of commentators on our rule proposal, including co-sponsors of the legislation and other members of Congress, have indicated that the Conflict Minerals Statutory Provision will provide information that is material to an investor's understanding of the risks in an issuer's reputation and supply chain.[17]

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[15] See Exchange Act Section 1502(c)(1)(B)(i) (stating that the Secretary of State, in consultation with the Administrator of the United States Agency for International Development, shall submit to Congress a plan to "promote peace and security" in the Covered Countries).

[16] See 156 CONG. REC. S3976 (daily ed. May 19, 2010) (statement of Sen. Feingold) ("Mr. President, I am pleased to be an original cosponsor of two amendments to the Restoring American Financial Stability Act that seek to ensure there is greater transparency around how international companies are addressing issues of foreign corruption and violent conflict that relate to their business. Creating these mechanisms to enhance transparency will help the United States and our allies more effectively deal with these complex problems, at the same time that they will also help American consumers and investors make more informed decisions.").

[17] See, e.g., letters from Aditi Mohapatra of Calvert Asset Management Company, Inc. on behalf of 49 investors, including the Social Investment Forum and Interfaith Center of Corporate Responsibility (Mar. 2, 2011) ("SIF I"); Boston Common Asset Management, LLC, Calvert Asset Management Co., Inc., Interfaith Center on Corporate Responsibility, Jesuit Conference of the United States, Marianist Province of the US, Mercy Investment Services, Inc., Missionary Oblates of Mary Immaculate, Responsible Sourcing Network, Sustainalytics, Trillium Asset Management, and Tri-State Coalition for Responsible Investment (Feb. 1, 2012) ("SIF II"); Calvert Investments (Oct. 18, 2011) ("Calvert"); General Board of Pension and Health Benefits of The United Methodist Church (Mar. 7, 2011) ("Methodist Pension"); State Board of Administration of Florida (Feb. 3, 2011) ("FRS"); and Teachers Insurance and Annuity Association and College Retirement Equities Fund (Mar. 2, 2011) ("TIAA-CREF"). See also letters from Catholic Relief Services (Feb. 8, 2011) ("CRS I") ("We submit these comments with the hope the SEC will consider the need of investors to access information to make sound business decisions that reflect both their social and their financial concerns."); Enough Project (Mar. 31, 2011) ("Enough Project II") (stating that advancing the "goal of resolving a humanitarian crisis that continues to cause countless deaths and unimaginable suffering" is "of great interest to many, including investors"); Senator Richard J. Durbin and Representative Jim McDermott (Feb. 28, 2011) ("Sen. Durbin / Rep. McDermott") (suggesting that the provision's purposes were both to end conflict in the DRC and to provide current information for investors, and the latter purpose is identical to the purpose of requiring the disclosure of other information in an issuer's the periodic reports) and Senator Patrick Leahy, Senator Christopher Coons, Congressman Howard

Exchange Act Section 13(p) mandates that we promulgate regulations requiring that a "person described"[18] disclose annually whether any "conflict minerals" that are "necessary to the functionality or production of a product manufactured by such person"[19] originated in the Covered Countries, and make that disclosure publicly available on the issuer's Internet website.[20] If such a person's conflict minerals originated in the Covered Countries, that person must submit a report ("Conflict Minerals Report") to us that includes a description of the measures taken by the person to exercise due diligence on the minerals' source and chain of custody.[21] Under Exchange Act Section 13(p), the measures taken to exercise due diligence "shall include an independent private sector audit" of the Conflict Minerals Report that is conducted according to standards established by the Comptroller General of the United States, in accordance with our promulgated rules, in consultation with the Secretary of State.[22] The person

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Berman, Congressman Jim McDermott, Congressman Donald Payne, Congressman Gregory Meeks, and Congressmember Karen Bass (Feb. 16, 2012) ("Sen. Leahy et al.") (asserting that an issuer's conflict minerals information is "critical to both investors and to capital formation" because "when a publicly traded company relies on an unstable black market for inputs essential to manufacturing its products it is of deep material interest to investors").

[18] The term "person described" is defined in Exchange Act Section 13(p)(2) as one who is required to file reports under Exchange Act Section 13(p)(1)(A), and for whom the conflict minerals are necessary to the functionality or production of a product manufactured by such person. Exchange Act Section 13(p)(1)(A) does not provide a definition but refers back to Exchange Act Section 13(p)(2).

[19] Exchange Act Section 13(p)(2)(B).

[20] See Exchange Act Section 13(p)(1)(E) (stating that each issuer "shall make available to the public on the Internet website of such [issuer] the information disclosed under" Exchange Act Section 13(p)(1)(A)).

[21] See Exchange Act Section 13(p)(1)(A)(i).

[22] See id. (requiring in the Conflict Minerals Report "a description of the measures taken by the person to exercise due diligence on the source and chain of custody of such [conflict] minerals, which measures shall include an independent private sector audit of such report"). The Conflict Minerals Statutory Provision assigns certain responsibilities to other federal agencies. In developing our proposed rules, our staff has consulted with the staff of these other agencies in developing our proposed rules. These agencies include,

submitting the Conflict Minerals Report must also identify the independent private sector auditor[23] and certify the independent private sector audit.[24]

Further, according to Exchange Act Section 13(p), the Conflict Minerals Report must include "a description of the products manufactured or contracted to be manufactured that are not DRC conflict free,"[25] the facilities used to process the conflict minerals, the country of origin of the conflict minerals, and "the efforts to determine the mine or location of origin with the greatest possible specificity."[26] Also, Exchange Act Section 13(p) dictates that each person described "shall make available to the public on the Internet website of such person" the conflict minerals information required by Exchange Act Section 13(p)(1)(A).[27]

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including the Government Accountability Office (the "GAO"), which is headed by the Comptroller General of the United States, and the United States Department of State.

[23] See Exchange Act Section 13(p)(1)(A)(ii) (stating that the issuer must provide a description of the "entity that conducted the independent private sector audit in accordance with" Exchange Act Section 13(p)(1)(A)(i)").

[24] As noted in Exchange Act Section 13(p)(1)(B), if an issuer is required to provide a Conflict Minerals Report that includes an independent private sector audit, that issuer "shall certify the audit" and that certified audit "shall constitute a critical component of due diligence in establishing the source and chain of custody of such minerals."

[25] The term "DRC conflict free" is defined in Exchange Act Section 13(p)(1)(A)(ii) and Exchange Act Section 13(p)(1)(D). Exchange Act Section 13(p)(1)(A)(ii) defines "DRC conflict free" as "the products that do not contain minerals that directly or indirectly finance or benefit armed groups in the" Covered Countries. Similarly, Exchange Act Section 13(p)(1)(D) defines "DRC conflict free" as products that do "not contain conflict minerals that directly or indirectly finance or benefit armed groups in the" Covered Countries. We note that the definitions in the two sections are slightly different in that Exchange Act Section 13(p)(1)(A)(ii) refers to "minerals" without any limitation, whereas Exchange Act Section 13(p)(1)(D) refers specifically to "conflict minerals." We believe, based on the totality of the Conflict Minerals Statutory Provision, that "DRC conflict free" is meant to refer only to "conflict minerals," as that term is defined in Section 1502(e)(4) of the Act, that directly or indirectly finance or benefit armed groups in the Covered Countries, and not to all minerals that directly or indirectly finance or benefit armed groups in the Covered Countries.

[26] See Exchange Act Section 13(p)(1)(A)(ii).

[27] See Exchange Act Section 13(p)(1)(E).

## B. Summary of the Proposed Rules

We proposed rules to apply to certain issuers that file reports with us under Exchange Act Sections 13(a)[28] or 15(d).[29] Based on the Conflict Minerals Statutory Provision, we proposed a disclosure requirement for conflict minerals that would divide into three steps. The first step would have required an issuer to determine whether it was subject to the Conflict Minerals Statutory Provision. An issuer would have only been subject to the Conflict Minerals Statutory Provision if it was a reporting issuer for which conflict minerals were "necessary to the functionality or production of a product manufactured"[30] or contracted to be manufactured by such person. If an issuer did not meet that definition, the issuer was not required to take any action, make any disclosures, or submit any reports. If, however, an issuer met this definition, that issuer would move to the second step.

The second step would have required the issuer to determine after a reasonable country of origin inquiry whether its conflict minerals originated in the Covered Countries. If the issuer determined that its conflict minerals did not originate in the Covered Countries, the issuer was to disclose this determination and the reasonable country of origin inquiry it used in reaching this determination in the body of its annual report. The issuer also would have been required to provide on its Internet website its determination that its conflict minerals did not originate in the Covered Countries, disclose in its annual report that the disclosure was posted on its Internet website, and

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28 15 U.S.C. 78m(a).

29 15 U.S.C. 78o(d).

30 Exchange Act Section 13(p)(2).

disclose the Internet address on which this disclosure was posted. It would further have been required to maintain records demonstrating that its conflict minerals did not originate in the Covered Countries. Such an issuer would not have any further disclosure or reporting obligations with regard to its conflict minerals.

If, however, the issuer determined that its conflict minerals did originate in the Covered Countries, if it was unable to conclude that its conflict minerals did not originate in the Covered Countries, or if it determined that its conflict minerals were from recycled or scrap sources, the issuer would have been required to disclose this conclusion in its annual report. Also, the issuer would have been required to note that the Conflict Minerals Report, which included the certified independent private sector audit report, was furnished as an exhibit to the annual report; furnish the Conflict Minerals Report; make available the Conflict Minerals Report on its Internet website; disclose that the Conflict Minerals Report was posted on its Internet website; and provide the Internet address of that site. This issuer would then have moved to the third step.

Finally, the third step would have required an issuer with conflict minerals that originated in the Covered Countries, or an issuer that was unable to conclude that its conflict minerals did not originate in the Covered Countries, to furnish a Conflict Minerals Report. The proposed rules would have required an issuer to provide, in its Conflict Minerals Report, a description of the measures it had taken to exercise due diligence on the source and chain of custody of its conflict minerals, which would have included a certified independent private sector audit of the Conflict Minerals Report that identified the auditor and was furnished as part of the Conflict Minerals Report. Further, the issuer would have been required to include in the Conflict Minerals Report a description of its products manufactured or contracted to be manufactured containing conflict minerals that it was unable to determine did not "directly or indirectly finance or benefit armed groups" in the Covered Countries. The issuer would identify such products by describing them in the Conflict Mineral Report as not "DRC conflict free."[31] If any of its products contained conflict minerals that did not "directly or indirectly finance or benefit" these armed groups, the issuer would be permitted to describe such products in the Conflict Mineral Report as "DRC conflict free" whether or not the minerals originated in the Covered Countries. In addition, the issuer would have been required to disclose in the Conflict Minerals Report the facilities used to process those conflict minerals, those conflict minerals' country of origin, and the efforts to determine the mine or location of origin with the greatest possible specificity.

The proposed rules would have allowed for different treatment of conflict minerals from recycled and scrap sources. An issuer with such conflict minerals would have been required to furnish a Conflict Minerals Report that described the measures taken to exercise due diligence in determining that its conflict minerals were from recycled or scrap sources and to provide the reasons for believing, based on its due diligence, that its conflict minerals were from recycled or scrap sources. Such an issuer would also have been required to obtain a certified independent private sector audit of the Conflict Minerals Report.

### C. Summary of Comments on the Proposed Rules

The Proposing Release requested comment on a variety of significant aspects of

[31] The definition of the term "DRC conflict free" in our proposed rules would be identical to the definition in Exchange Act Section 13(p)(1)(D).

the proposed rules. The original comment period in the Proposing Release was to end on January 31, 2011. Prior to that date, however, we received requests for an extension of time for public comment on the proposal to allow for, among other matters, the collection of information and to improve the quality of responses.[32] On January 28, 2011, we extended the comment period for the proposal from January 31, 2011 to March 2, 2011.[33] Additionally, in response to suggestions from commentators,[34] we held a public roundtable on October 18, 2011 ("SEC Roundtable") at which invited participants, including investors, affected issuers, human rights organizations, and other stakeholders, discussed their views and provided input on issues related to our required rulemaking.[35] In conjunction with the SEC Roundtable, we requested further comment.[36] We received approximately 420 individual comment letters in response to the proposed rules, with approximately 145 of those letters being received after the SEC Roundtable, and over 40

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[32] See letters from Advanced Medical Technology Association, Aerospace Industries Association, American Association of Exporters and Importers, American Automotive Policy Council, Business Alliance for Customs Modernization, IPC – Association Connecting Electronics Industries Joint Industry Group, National Association of Manufacturers, National Electrical Manufacturers Association, National Foreign Trade Council, National Retail Federation, Retail Industry Leaders Association, Semiconductor Equipment and Materials International, TechAmerica, USA*ENGAGE, and U.S. Chamber of Commerce (Dec. 16, 2010) ("Advanced Medical Technology Association et al."); Jewelers Vigilance Committee, American Gem Society, Manufacturing Jewelers & Suppliers of America, Jewelers of America, and Fashion Jewelry & Accessories Trade Association (Jan. 10, 2011) ("JVC et al. I"); National Mining Association (Jan. 3, 2011) ("NMA I"); National Stone, Sand Gravel Association (Jan. 13, 2011) ("NSSGA"); Representative Spencer Bachus (Jan. 25, 2011) ("Rep. Bachus"); Robert D. Hormats, Under Secretary of State for Economic, Energy, and Agricultural Affairs, and Maria Otero, Democracy and Global Affairs (Jan. 25, 2011) ("State I"); and World Gold Council (Jan. 7, 2011) ("WGC I").

[33] Conflict Minerals, Release No. 34-63793 (Jan. 28, 2011) [76 FR 6110].

[34] See, e.g., letter from United States Chamber of Commerce (Feb. 28, 2011) ("Chamber I").

[35] See Press Release, Securities and Exchange Commission, SEC Announces Agenda and Panelists for Roundtable on Conflict Minerals (Oct. 14, 2011), available at http://www.sec.gov/news/press/2011/2011-210.htm.

[36] Roundtable on Issues Relating to Conflict Minerals, Release No. 34-65508 (Oct. 7, 2011) [76 FR 63573].

letters regarding the Conflict Minerals Statutory Provision prior to the proposed rules.[37] We also received approximately 13,400 form letters from those supporting "promptly" implementing a "strong" final rule regarding the Conflict Minerals Statutory Provision,[38] with approximately 9,700 of those letters requesting some specific requirements in the final rule,[39] and two petitions supporting the proposed amendments with an aggregate of over 25,000 signatures.

The comment letters came from corporations, professional associations, human rights and public policy groups, bar associations, auditors, institutional investors,

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[37] To facilitate public input on rulemaking required by the Act, the Commission provided a series of e-mail links, organized by topic, on its website at http://www.sec.gov/spotlight/regreformcomments.shtml. The comments relating to the Conflict Minerals Statutory Provision are located at http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specialized-disclosures.shtml ("Pre-Proposing Release website"). These comments were received before we made public the Proposing Release or proposed rules and are separate from the comments we received after we published the Proposing Release and proposed rules, which are located at http://www.sec.gov/comments/s7-40-10/s74010.shtml ("Post-Proposing Release website"). Many commentators provided comments on both the pre- and post-Proposing Release websites. Generally, our references to comment letters refer to the comments on the post-Proposing Release website. When we refer to a comment letter from the Pre-Proposing Release website, however, we make that clear in the footnote.

[38] See form letters A (urging us to institute "strong rules"), B (urging that the final rule not allow the legislation's intent to be compromised and to keep the "LEGISLATION STRONG" (emphasis in original)), E (indicating "deep disappointment and concern" that the final rule had not been adopted, and urging us to "release a strong, final rule"), F (urging us to "promptly issue strong final regulations"), G (stating that delays in adopting a final rule will "significantly hinder progress toward a legitimate mining sector in eastern" DRC, and urging us to "urgently release final regulations on conflict minerals"), H (calling on us to "release a strong, final rule as soon as possible"), and I (urging us to "issue strong final rules as soon as possible").

[39] See form letters A (stating that the final rule should, among other requirements, include gold and metals mining companies, apply to all possible companies, require that conflict minerals disclosures be filed, include strong and defined due diligence, and define recycled metals as 100% post-consumer metals), G (stating that the final rule should "incorporate the UN Group of Experts and OECD due diligence guidelines' concept of mitigation"), H (stating that the final rule should, among other requirements, reject any delays or phased-in implementation, adopt the "OECD due diligence standard ," have equal reporting for all conflict minerals, include all companies regardless of size, define terms narrowly, define the reasonable country of origin inquiry, have issuers file reports, and not include a de minimis category for conflict minerals), and I (stating that the final rule must, among other requirements, reject an indeterminate origin category, define the reasonable country of origin standard, and adopt the "OECD Due Diligence standard").

investment firms, United States and foreign government officials,[40] and other interested parties and stakeholders. In general, most commentators supported the human rights objectives of the Conflict Minerals Statutory Provision and the proposed rules.[41] As discussed in greater detail throughout this release, however, many of these commentators provided recommendations for revising the proposed rules and suggested modifications or alternatives to the proposal. Only a few commentators generally opposed the Conflict Minerals Statutory Provision and/or our adoption of any rule based on the provision.[42] One commentator recommended that the proposed rules be withdrawn entirely "and that the potential costs, supply chain complexities, and other practical obstacles to

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[40] Among the foreign officials to provide comment letters was the DRC's Minister of Mines. See letters from Martin Kabwelulu, Minister of Mines, Democratic Republic of the Congo (July 15, 2011) ("DRC Ministry of Mines I"); Martin Kabwelulu, Minister of Mines, Democratic Republic of the Congo (Oct. 15, 2011) ("DRC Ministry of Mines II"); and Martin Kabwelulu, Minister of Mines, Democratic Republic of the Congo (Nov. 8, 2011) ("DRC Ministry of Mines III").

[41] See, e.g., letters from Advanced Medical Technology Association, American Apparel & Footwear Association, American Association of Exporters and Importers, Consumer Electronics Association, Consumer Electronics Retailers Coalition, Emergency Committee for American Trade, IPC-Association Connecting Electronics Industries, Joint Industry Group, National Association of Manufacturers, National Foreign Trade Council, National Retail Federation, Retail Industry Leaders Association, TechAmerica, and USA Engage (Mar. 2, 2011) ("Industry Group Coalition I") (stating its "support [for] the underlying goal of Sec. 1502 to prevent the atrocities occurring" in the Covered Countries); American Bar Association (Jun. 20, 2011) ("ABA") (stating that it "supports and endorses the humanitarian efforts to end the armed conflict in the eastern Democratic Republic of the Congo"); Chamber I (stating that it "supports the fundamental goal, as embodied in Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ('Dodd-Frank Act'), of preventing the exploitation of conflict minerals for the purpose of financing human rights violations within the Democratic Republic of Congo"); National Association of Manufacturers (Mar. 2, 2011) ("NAM I") (stating its "support the underlying goal of Sec. 1502 to address the atrocities occurring in the" Covered Countries); and World Gold Council (Feb. 28, 2011) ("WGC II") (stating that it "believes it is important to state [its] support for the humanitarian goals of Section 1502").

[42] See, e.g., letters from Michael Beggs (Jan. 12, 2012) ("Beggs"), Charles Blakeman (Oct. 9, 2011) ("Blakeman I"), Gary P. Bradley (Sept. 19, 2011) ("Bradley"), Joseph Cummins (Dec. 20, 2011) ("Cummins"), Walter Grail (Oct. 1, 2011) ("Grail"), Kirtland C. Griffin (Jun. 16, 2011) ("Griffin"), Clark Grey Howell (Sep. 20, 2011) ("Howell"), Edward Lynch (Dec. 16, 2011) ("Lynch"), and Melanie Matthews (Sep. 19, 2011) ("Matthews").

implementation be more fully analyzed before new rules are proposed."[43]

Also, although they may have offered their support of the human rights concerns underlying the Conflict Minerals Statutory Provision and the proposed rules, some commentators were concerned about potentially negative effects of the Conflict Minerals Statutory Provision and the resulting rule. In this regard, some of those commentators argued that the provision and/or rule could lead to a de facto boycott or embargo on conflict minerals from the Covered Countries,[44] other of these commentators suggested

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[43] See letter from Chamber I. See also letters from Chamber II (reiterating the withdrawal request from its initial comment letter and requesting we open a second comment period regarding the proposed rules), Chamber III (requesting that we allow companies additional time for commenting on the proposed rules), and United States Chamber of Commerce (Jul. 11, 2012) ("Chamber IV") (requesting that we re-propose the rule and re-open the comment period).

[44] See, e.g., letters from AngloGold Ashanti Limited (Jan. 31, 2011) ("AngloGold"), Bureau d'Etudes Scientifiques et Techiques (Dec. 26, 2011) ("BEST II"), Competitive Enterprise Institute (Mar. 2, 2011) ("CEI I"), Competitive Enterprise Institute (Aug. 22, 2011) ("CEI II"), Fédération des Enterprises du Congo (Oct. 28, 2011) ("FEC II"), Générale des Coopératives Minières du Sud Kivu (Apr. 8, 2011) ("Gecomiski"), IPC – Association Connecting Electronics Industries (Mar. 2, 2011) ("IPC I"), ITRI Ltd. (Feb. 25, 2011) ("ITRI II"), London Bullion Market Association (Mar. 2, 2011) ("LBMA I"), London Bullion Market Association (Aug. 5, 2011) ("LBMA II"), Minister of Energy and Minerals of the United Republic of Tanzania (May 23, 2011) ("Tanzania I"), Ministry of Mines and Energy of the Republic of Burundi (May 12, 2011) ("Burundi"), North Kivu Artisanal Mining Cooperatives Representative (Mar. 1, 2011) ("Comimpa"), Pact Inc. (Mar. 2, 2011) ("Pact I"), Pact Inc. (Oct. 13, 2011) ("Pact II"), Representative Christopher J. Lee (Feb. 3, 2011) ("Rep. Lee"), Société Minière du Maniema SPRL (Mar. 21, 2012) ("Somima"), Verizon Communications (Jun. 24, 2011) ("Verizon"), and WGC II. But see letters from Enough Project (Mar. 2, 2011) ("Enough Project I") ("Enough notes that critics of the legislation are quick to predict that private sector investors and companies may walk away from the Congo if faced with meaningful due diligence and reporting requirements. On the contrary, Congo's mineral reserves are too great for world markets to ignore."), International Corporate Accountability Roundtable (Aug. 24, 2011) ("ICAR II") (recognizing that "[c]ritics of the law are arguing that whatever its intentions, it will in practice end the trade in minerals mined in the east of Congo," and that, although "mineral exports from the region have dropped significantly in recent months, and that this has forced many artisanal miners to seek alternative livelihoods," which "has serious implications for miners and their families," the "downturn stems from a six month suspension of mining and trading activities imposed by the Congolese government and an overly restrictive interpretation of Dodd Frank by industry associations" and the "idea that the current hiatus is a permanent shut-down of the trade is misplaced, however."), Andrew Matheson (Oct. 26, 2011) ("Matheson II") ("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."), and Sen. Durbin / Rep. McDermott ("NGO experts in Congo note that only approximately one percent of the Congolese workforce depends on mining, so even if a de facto ban came to pass - which we doubt - the economic impact would not be as great as commonly assumed.").

that the provision and/or rule could compel speech in a manner that violates the First Amendment,[45] and at least one such commentator indicated that the final rule would adversely affect employment in the United States.[46] One commentator, however, suggested that there could be some "business benefits" from complying with the final rule beyond the humanitarian benefits discussed by Congress.[47] This commentator argued that such benefits could include eliminating any competitive disadvantage to companies already engaged in ensuring their conflict mineral purchases do not fund conflict in the DRC, providing an opportunity to improve a company's existing risk management and supply chain management, stimulating innovation, supporting companies' requests for conflict minerals information from suppliers through legal mandate, and preparing companies to meet a new generation of expectations for greater supply chain transparency and accountability.[48]

We have reviewed and considered all of the comments that we received relating to the rulemaking. The final rule reflects changes from the proposed rules made in response to many of these comments. As discussed throughout this release, we are adopting final rules designed to provide flexibility to issuers to reduce their compliance costs. At the same time, our final rules retain the requirements from our proposed rules

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[45] See, e.g., letters from Taiwan Semiconductor Manufacturing Company Ltd. (Jan. 27, 2011) ("Taiwan Semi"), Tiffany & Co. (Feb. 22, 2011) ("Tiffany"), and Washington Legal Fund (Mar. 30, 2011) ("WLF").

[46] See letter from Rep. Lee ("Ultimately, these new regulations may cost U.S. jobs and send them overseas.").

[47] See letter from Green Research (Jan. 27, 2012) ("Green II"). See also letter from Green Research (Oct. 29, 2011) ("Green I") (stating that, although "[i]t seems clear that, by most accounting, there are costs of compliance" of the Conflict Minerals Statutory Provision, "there are benefits as well").

[48] See id.

that create the disclosure regime mandated by Congress by means of Exchange Act reporting requirements. We discuss our revisions with respect to each proposed rule amendment in more detail throughout this release.

## D. Summary of Changes to the Final Rule

We are adopting a three-step process, as proposed, but some of the mechanisms within the three steps have been modified in response to comments. We recognize that the final rule will impose significant compliance costs on companies who use or supply conflict minerals, and in modifying the rule we tried to reduce the burden of compliance in areas in which we have discretion while remaining faithful to the language and intent of the Conflict Minerals Statutory Provision that Congress adopted. A flowchart presenting a general overview of the conflict minerals rule that we are adopting is included following the end of this section. The chart is intended merely as a guide, however, and issuers should refer to the rule text and the preamble's more complete narrative description for the requirements of the rule.

The first step continues to be for an issuer to determine whether it is subject to the requirements of the Conflict Minerals Statutory Provision. Pursuant to the Conflict Minerals Statutory Provision, the Commission is required to promulgate regulations requiring certain conflict minerals disclosures by any "person described," which, under the Conflict Minerals Statutory Provision, includes one for whom "conflict minerals are necessary to the functionality or production of a product manufactured by such person"[49]. As in our proposal, under the final rule this includes issuers whose conflict minerals are

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[49] Exchange Act Section 13(p)(2).

necessary to the functionality or production of a product manufactured or contracted by that issuer to be manufactured.[50] If an issuer does not meet this definition, the issuer is not required to take any action, make any disclosures, or submit any reports under the final rule. If, however, an issuer meets this definition, that issuer moves to the second step.

In the final rule, some aspects of the first step differ from the proposed rules based on comments we received. Consistent with the proposal, the final rule does not define the phrases "contract to manufacture," "necessary to the functionality" of a product, and "necessary to the production" of a product. In response to comments, however, we provide additional guidance for issuers to consider regarding whether those phrases apply to them.[51] The guidance states that whether an issuer will be considered to "contract to manufacture" a product depends on the degree of influence it exercises over the materials, parts, ingredients, or components to be included in any product that contains conflict minerals or their derivatives. An issuer will not be considered to "contract to manufacture" a product if it does no more than take the following actions: (1) the issuer specifies or negotiates contractual terms with a manufacturer that do not directly relate to the manufacturing of the product (unless it specifies or negotiates taking these actions so as to exercise a degree of influence over the manufacturing of the product that is practically equivalent to contracting on terms that directly relate to the manufacturing of

[50] See Exchange Act Section 13(p)(1)(ii) (requiring a person described to include a description of certain of the person's products that were manufactured by the person, or were contracted by the person to be manufactured).

[51] In the Proposing Release, although we did not provide guidance for the other phrases, we provided some guidance for the phrase "necessary to the production" of a product. As discussed below, we are revising the guidance for this phrase.

the product); (2) the issuer affixes its brand, marks, logo, or label to a generic product manufactured by a third party; or (3) the issuer services, maintains, or repairs a product manufactured by a third party.

Similarly, the determination of whether a conflict mineral is deemed "necessary to the functionality" or "necessary to the production" of a product depends on the issuer's particular facts and circumstances, as discussed in more detail below. But to assist issuers in making their determination, we provide guidance for issuers. In determining whether a conflict mineral is "necessary to the functionality" of a product, an issuer should consider: (1) whether the conflict mineral is intentionally added to the product or any component of the product and is not a naturally-occurring by-product; (2) whether the conflict mineral is necessary to the product's generally expected function, use, or purpose; and (3) if conflict mineral is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration.

In determining whether a conflict mineral is "necessary to the production" of a product, an issuer should consider: (1) whether the conflict mineral is intentionally included in the product's production process, other than if it is included in a tool, machine, or equipment used to produce the product (such as computers or power lines); (2) whether the conflict mineral is included in the product; and (3) whether the conflict mineral is necessary to produce the product. In this regard, we are modifying our guidance from the proposal such that, for a conflict mineral to be considered "necessary to the production" of a product, the mineral must be both contained in the product and necessary to the product's production. We do not consider a conflict mineral "necessary to the production" of a product if the conflict mineral is used as a catalyst, or in a similar manner in another process, that is necessary to produce the product but is not contained in that product.

Further, in a change from the proposal and in response to comments suggesting that including mining would expand the statutory mandate, the final rule does not treat an issuer that mines conflict minerals as manufacturing those minerals unless the issuer also engages in manufacturing. Additionally, the final rule exempts any conflict minerals that are "outside the supply chain" prior to January 31, 2013. Under the final rule, conflict minerals are "outside the supply chain" if they have been smelted or fully refined or, if they have not been smelted or fully refined, they are outside the Covered Countries. In response to comments, the final rule allows issuers that obtain control over a company that manufactures or contracts for the manufacturing of products with necessary conflict minerals that previously had not been obligated to provide a specialized disclosure report for those minerals to delay reporting on the acquired company's products until the end of the first reporting calendar year that begins no sooner than eight months after the effective date of the acquisition.

As suggested by commentators, the final rule modifies the proposal as to the location, timing, and status of any conflict minerals disclosures and any Conflict Minerals Report. The final rule requires an issuer to provide the conflict minerals disclosures that would have been in the body of the annual report in the body of a new specialized disclosure report on a new form, Form SD. An issuer required to provide a Conflict Minerals Report will provide that report as an exhibit to the specialized disclosure report. Additionally, based on comments that it will reduce the burdens on supply chain participants, the final rule requires that the conflict minerals information in the specialized disclosure report and/or in the Conflict Minerals Report cover the calendar year from January 1 to December 31 regardless of the issuer's fiscal year end, and the specialized disclosure report covering the prior year must be provided each year by May 31. Further, in a change from the proposal, urged by multiple commentators, the final rule requires Form SD, including the conflict minerals information therein and any Conflict Minerals Report submitted as an exhibit to the form, to be "filed" under the Exchange Act and thereby subject to potential Exchange Act Section 18 liability. The proposal would have required the information to be "furnished."

The second step continues to require an issuer to conduct a reasonable country of origin inquiry regarding the origin of its conflict minerals. Consistent with the proposal, and the position of certain commentators,[52] the final rule does not prescribe the actions for a reasonable country of origin inquiry that are required, as the required inquiry depends on each issuer's facts and circumstances. However, in a change from the proposed rules, to clarify the scope of the required inquiry as requested by certain other commentators,[53] the final rule provides general standards applicable to the inquiry.

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[52] Some commentators agreed that, to allow for greater flexibility, the reasonable country of origin inquiry standard should either not be defined or that only general guidance should be provided. See, e.g., letters from Apparel & Footwear Association (Mar. 2, 2011) ("AAFA"); AngloGold; ArcelorMittal (Oct. 31, 2011) ("ArcelorMittal"); Industry Group Coalition I; IPC I; Information Technology Industry Council (Feb. 24, 2011) ("ITIC I"); International Precious Metals Institute (Jan. 19, 2011) ("IPMI I"); Jewelers Vigilance Committee, American Gem Society, Manufacturing Jewelers & Suppliers of America, Jewelers of America, and Fashion Jewelry & Accessories Trade Association (Mar. 2, 2011) ("JVC et al. II"); NAM I, Retail Industry Leaders Association and Consumer Electronics Retailers Coalition (Mar. 2, 2011) ("RILA-CERC"); Semiconductor Industry Association (Mar. 2, 2011) ("Semiconductor"); SIF I; TriQuint Semiconductor, Inc. (Jan. 26, 2011) ("TriQuint I"); and WGC II.

[53] Some commentators argued that either the reasonable country of origin inquiry standard should be defined or that there should specific guidance regarding the standard. See, e.g., letters from Business Roundtable (Mar. 2, 2011) ("Roundtable"), CRS I, Department of State (Mar. 24, 2011) ("State II"),

Specifically, the final rule provides that, to satisfy the reasonable country of origin inquiry requirement, an issuer must conduct an inquiry regarding the origin of its conflict minerals that is reasonably designed to determine whether any of its conflict minerals originated in the Covered Countries or are from recycled or scrap sources, and must perform the inquiry in good faith. The final rule requires an issuer that determines that its conflict minerals did not originate in the Covered Countries or did come from recycled or scrap sources to disclose in its specialized disclosure report its determination and in its specialized disclosure report briefly describe the reasonable country of origin inquiry it used in reaching the determination and the results of the inquiry. The requirement for an issuer to briefly describe its inquiry and the results of the inquiry is a change from the disclosure required in the proposed rules.

Also, in a change from the proposal, the final rule modifies the trigger for determining whether or not an issuer is required to proceed to step three under the rule. The proposed rules would have required an issuer to conduct due diligence on the source and chain of custody of its conflict minerals and provide a Conflict Minerals Report if, based on its reasonable country of origin inquiry, it determined that its conflict minerals

EARTHWORKS' No Dirty Gold Campaign (Mar. 2, 2011) ("Earthworks"), Enough Project I, Ethical Metalsmiths (Feb. 28, 2011) ("Metalsmiths"), General Board of Church and Society of the United Methodist Church (Apr. 19, 2012) ("Methodist Board"), Global Witness (Feb. 28, 2011) ("Global Witness I"), Howland Greene Consultants LLC (Jan. 28, 2011) ("Howland"), International Conference of the Great Lakes Region (Jan. 31, 2011) ("ICGLR"), National Association of Evangelicals (Feb. 17, 2012) ("Evangelicals"), New York City Bar Association (Jan. 31, 2011) ("NYCBar I"), New York City Bar Association (Feb. 8, 2012) ("NYCBar II"), Personal Care Products Council (Mar. 1, 2011) ("PCP"), Presbyterian Church USA (Feb. 23, 2012) ("Presbyterian Church II"), Semiconductor Equipment and Materials International (Feb. 15, 2011) ("SEMI"), Sen. Durbin / Rep. McDermott, Tantalum-Niobium International Study Center (Jan. 27, 2011) ("TIC"), Twenty-four organizations of the Multi-Stakeholder Group (Mar. 2, 2011) ("MSG I"), and World Evangelical Alliance (Feb. 17, 2012) ("Evangelical Alliance").

originated in the Covered Countries or was unable to determine that its conflict minerals did not originate in the Covered Countries, or if its conflict minerals came from recycled or scrap sources. Under the final rule, an issuer must exercise due diligence on the source and chain of custody of its conflict minerals and provide a Conflict Minerals Report if, based on its reasonable country of origin inquiry, the issuer knows that it has necessary conflict minerals that originated in the Covered Countries and did not come from recycled or scrap sources, or if the issuer has reason to believe that its necessary conflict minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources.

As an exception to this requirement, however, an issuer that must conduct due diligence because, based on its reasonable country of origin inquiry, it has reason to believe that its necessary conflict minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources is not required to submit a Conflict Minerals Report if, during the exercise of its due diligence, it determines that its conflict minerals did not, in fact, originate in the Covered Countries, or it determines that its conflict minerals did, in fact, come from recycled or scrap sources. Such an issuer is still required to submit a specialized disclosure report disclosing its determination and briefly describing its inquiry and its due diligence efforts and the results of that inquiry and due diligence efforts, which should demonstrate why the issuer believes that the conflict minerals did not originate in the Covered Countries or that they did come from recycled or scrap sources. On the other hand, if, based on its reasonable country of origin inquiry, an issuer has no reason to believe that its conflict minerals may have originated in the Covered Countries, or, based on its reasonable country of origin inquiry, an issuer reasonably believes that its conflict minerals are from recycled or scrap sources, the issuer is not required to move to step three. In another change from the proposal, the final rule does not require an issuer to retain reviewable business records to support its reasonable country of origin conclusion, although maintenance of appropriate records may be useful in demonstrating compliance with the final rule, and may be required by any nationally or internationally recognized due diligence framework applied by an issuer.

As noted above, if the issuer knows that it has necessary conflict minerals that originated in the Covered Countries, or if the issuer has reason to believe that its necessary conflict minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources, the issuer must move to the third step. The third step, consistent with the proposal, requires such an issuer to exercise due diligence on the source and chain of custody of its conflict minerals and provide a Conflict Minerals Report describing its due diligence measures, among other matters. As noted above, however, the final rule requires an issuer to provide its Conflict Minerals Report as an exhibit to its specialized disclosure report on Form SD, instead of as an exhibit to its annual report on Form 10-K, Form 20-F, or Form 40-F, as proposed.

Generally, the content of the Conflict Minerals Report is substantially similar to the proposal. One modification from the proposal, based on comments we received, is that the final rule requires an issuer to use a nationally or internationally recognized due diligence framework, if such a framework is available for the specific conflict mineral. We are persuaded by commentators that doing so will enhance the quality of an issuer's due diligence, promote comparability of the Conflict Minerals Reports of different issuers, and provide a framework by which auditors can assess an issuer's due diligence.[54] This requirement should make the rule more workable and less costly than if no framework was specified. Presently, it appears that the only nationally or internationally recognized due diligence framework available is the due diligence guidance approved by the Organisation for Economic Co-operation and Development ("OECD").[55]

As proposed, the final rule requires an independent private sector audit of an issuer's Conflict Minerals Report. However, in response to comments, we modified the proposal such that the final rule specifies an audit objective. The audit's objective is to express an opinion or conclusion as to whether the design of the issuer's due diligence measures as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is in conformity with, in all material respects, the criteria set forth in the nationally or internationally recognized due diligence framework used by the issuer, and whether the issuer's description of the due diligence measures it performed as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is consistent with the due diligence process that the issuer undertook. Also, consistent with the proposal, the final rule refers to the audit standards established by the GAO. The GAO staff has indicated to our staff that the GAO does not intend to establish new

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[54] The proposed rules would not have required the use of a particular due diligence framework, but the Proposing Release indicated that an issuer whose conduct conformed to a nationally or internationally recognized set of standards of, or guidance for, due diligence regarding its conflict minerals supply chain would provide evidence that the issuer used due diligence in its Conflict Minerals Report.

[55] See OECD, OECD DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS (2011), available at http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/46740847.pdf.

standards for the Conflict Minerals Report audit. Instead, the GAO plans to look to its existing Government Auditing Standards ("GAGAS"), which is commonly referred to as "the Yellow Book."[56]

Unlike the proposed rule, which would have required descriptions in the Conflict Minerals Report of an issuer's products that "are not 'DRC conflict free,'" where "DRC conflict free" means that they "do not contain minerals that directly or indirectly finance or benefit armed groups in the" Covered Countries, the final rule requires descriptions in the Conflict Minerals Report of an issuer's products "that have not been found to be 'DRC conflict free.'" We believe this change will lead to more accurate disclosure.

As suggested by a number of commentators, the final rule also modifies the proposal by providing a temporary transition period for two years for all issuers and four years for smaller reporting companies.[57] During this period, issuers may describe their products as "DRC conflict undeterminable" if they are unable to determine that their minerals meet the statutory definition of "DRC conflict free" for either of two reasons: First, they proceeded to step three based upon the conclusion, after their reasonable country of origin inquiry, that they had conflict minerals that originated in the Covered Countries and, after the exercise of due diligence, they are unable to determine if their conflict minerals financed or benefited armed groups in the Covered Countries; or second, they proceeded to step three based upon the conclusion, after their reasonable country of origin inquiry, that they had a reason to believe that their necessary conflict

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56 See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-331G, GOVERNMENT AUDITING STANDARDS 2011 REVISION (Dec. 2011), available at http://www.gao.gov/assets/590/587281.pdf.

57 "Smaller reporting company" is defined in Rule 12b-2 [17 CFR 240.12b-2] under the Exchange Act.

minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources and the information they gathered as a result of their subsequently required exercise of due diligence failed to clarify the conflict minerals' country of origin, whether the conflict minerals financed or benefited armed groups in those countries, or whether the conflict minerals came from recycled or scrap sources. These issuers will have already conducted a reasonable country of origin inquiry, and their undeterminable status would be based on the information they were able to gather from their exercise of due diligence. However, if these products also contain conflict minerals that the issuer knows directly or indirectly financed or benefited armed groups in the Covered Countries, the issuer may not describe those products as "DRC conflict undeterminable." Also, during the transition period, issuers with products that may be described as "DRC conflict undeterminable" are not required to have their Conflict Minerals Report audited. Such issuers, however, must still file a Conflict Minerals Report describing their due diligence, and must additionally describe the steps they have taken or will take, if any, since the end of the period covered in their most recent prior Conflict Minerals Report, to mitigate the risk that their necessary conflict minerals benefit armed groups, including any steps to improve their due diligence.

This temporary provision will apply for the first two reporting calendar years after effectiveness of the final rule for all issuers that are not smaller reporting companies, and for the first four reporting calendar years after effectiveness of the final rule for smaller reporting companies. We believe it is appropriate to allow a two-year temporary period, in recognition that, as commentators noted, the processes for tracing conflict minerals through the supply chain must develop further to make such determinations for the issuer community at large. Also, we believe it is appropriate to allow an additional two years to this temporary period for smaller reporting companies because, as commentators noted, smaller companies may face disproportionally higher burdens than larger companies and a longer temporary period may help alleviate some of those burdens. After the four-year period for smaller reporting companies and two-year period for all other issuers, issuers that have proceeded to step three but are unable to determine that their conflict minerals did not originate in the Covered Countries or are unable to determine that their conflict minerals that originated in the Covered Countries did not directly or indirectly finance or benefit armed groups must describe their products containing those conflict minerals as not having been found to be "DRC conflict free."

Unlike the proposed rules, the final rule requires issuers with necessary conflict minerals exercising due diligence regarding whether their conflict minerals are from recycled or scrap sources to conform the due diligence to a nationally or internationally recognized due diligence framework, if one is available for a particular recycled or scrap conflict mineral. A gold supplement to the OECD's due diligence guidance has been approved by the OECD.[58] This gold supplement is presently the only nationally or internationally recognized due diligence framework for any conflict mineral from recycled or scrap sources of which we are aware. Therefore, we anticipate that issuers will use the OECD gold supplement to conduct their due diligence for recycled or scrap gold. We are not aware that the OECD or any other body has a similar recycled or scrap

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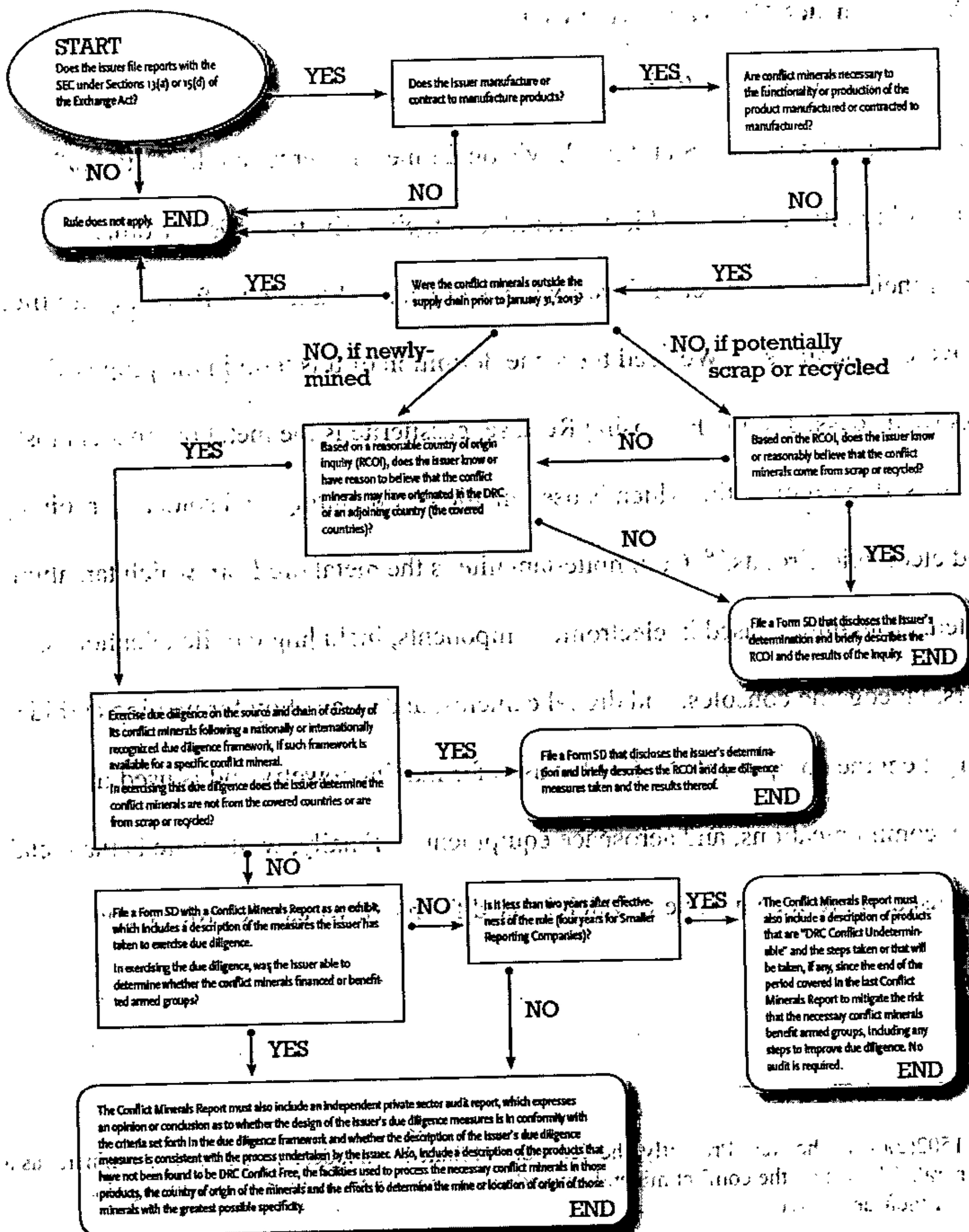
[58] See OECD, DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS: SUPPLEMENT ON GOLD (2012), available at http://www.oecd.org/corporate/guidelinesformultinationalenterprises/FINAL%20Supplement%20on%20Gold.pdf.

due diligence framework for the other conflict minerals. Issuers with conflict minerals without a nationally or internationally recognized due diligence framework are still required to exercise due diligence in determining that their conflict minerals were from recycled or scrap sources. The due diligence that must be exercised regarding such conflict minerals focuses only on whether those conflict minerals are from recycled or scrap sources. In such circumstances where a nationally or internationally recognized due diligence framework becomes available for any such conflict mineral, issuers will be required to utilize that framework in exercising due diligence to determine that conflict minerals are from recycled or scrap sources.

## E. Flowchart Summary of the Final Rule


START
Does the issuer file reports with the SEC under Sections 13(a) or 15(d) of the Exchange Act?
YES
Does the Issuer manufacture or contract to manufacture products?
YES
Are conflict minerals necessary to the functionality or production of the product manufactured or contracted to manufactured?
NO
NO
NO
Rule does not apply. END
YES
Were the conflict minerals outside the supply chain prior to January 31, 2013?
YES
NO, if newly-mined
NO, if potentially scrap or recycled
YES
Based on a reasonable country of origin inquiry (RCOI), does the issuer know or have reason to believe that the conflict minerals may have originated in the DRC or an adjoining country (the covered countries)?
NO
Based on the RCOI, does the issuer know or reasonably believe that the conflict minerals come from scrap or recycled?
NO
YES
File a Form SD that discloses the Issuer's determination and briefly describes the RCOI and the results of the Inquiry. END
Exercise due diligence on the source and chain of custody of its conflict minerals following a nationally or internationally recognized due diligence framework, if such framework is available for a specific conflict mineral.
In exercising this due diligence does the Issuer determine the conflict minerals are not from the covered countries or are from scrap or recycled?
YES
File a Form SD that discloses the issuer's determination and briefly describes the RCOI and due diligence measures taken and the results thereof. END
NO
File a Form SD with a Conflict Minerals Report as an exhibit, which includes a description of the measures the issuer has taken to exercise due diligence.
In exercising the due diligence, was the Issuer able to determine whether the conflict minerals financed or benefitted armed groups?
NO
Is it less than two years after effectiveness of the rule (four years for Smaller Reporting Companies)?
YES
The Conflict Minerals Report must also include a description of products that are "DRC Conflict Undeterminable" and the steps taken or that will be taken, if any, since the end of the period covered in the last Conflict Minerals Report to mitigate the risk that the necessary conflict minerals benefit armed groups, including any steps to improve due diligence. No audit is required. END
NO
YES
The Conflict Minerals Report must also include an independent private sector audit report, which expresses an opinion or conclusion as to whether the design of the issuer's due diligence measures is in conformity with the criteria set forth in the due diligence framework and whether the description of the issuer's due diligence measures is consistent with the process undertaken by the issuer. Also, include a description of the products that have not been found to be DRC Conflict Free, the facilities used to process the necessary conflict minerals in those products, the country of origin of the minerals and the efforts to determine the mine or location of origin of those minerals with the greatest possible specificity. END

## II. DISCUSSION OF THE FINAL RULE

### A. "Conflict Minerals" Definition

#### 1. Proposed Rules

The Conflict Minerals Statutory Provision defines the term "conflict mineral" as cassiterite, columbite-tantalite, gold, wolframite, or their derivatives, or any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the Covered Countries.[59] We used the same definition of this term in the proposed rules. As we discussed in the Proposing Release, cassiterite is the metal ore that is most commonly used to produce tin, which is used in alloys, tin plating, and solders for joining pipes and electronic circuits.[60] Columbite-tantalite is the metal ore from which tantalum is extracted. Tantalum is used in electronic components, including mobile telephones, computers, videogame consoles, and digital cameras, and as an alloy for making carbide tools and jet engine components.[61] Gold is used for making jewelry and is used in electronic, communications, and aerospace equipment.[62] Finally, wolframite is the metal ore that is used to produce tungsten, which is used for metal wires, electrodes, and

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[59] Section 1502(e)(4) of the Act. Presently, the Secretary of State has not designated any other mineral as a conflict mineral. Therefore, the conflict minerals include only cassiterite, columbite-tantalite, gold, wolframite, or their derivatives.

[60] Tin Statistics and Information, U.S. GEOLOGICAL SURVEY, available at http://minerals.usgs.gov/minerals/pubs/commodity/tin/.

[61] Niobium (Columbium) and Tantalum Statistics and Information, U.S. GEOLOGICAL SURVEY, available at http://minerals.usgs.gov/minerals/pubs/commodity/niobium.

[62] Gold Statistics and Information, U.S. GEOLOGICAL SURVEY, available at http://minerals.usgs.gov/minerals/pubs/commodity/gold.

contacts in lighting, electronic, electrical, heating, and welding applications.[63] Based on the many uses of these minerals, we expect the Conflict Minerals Statutory Provision to apply to many companies and industries and, thereby, the final rule to apply to many issuers.

### 2. Comments on the Proposed Rules

Several commentators requested that the final rule set forth the specific conflict derivatives that would trigger the rule's disclosure and reporting obligations.[64] Many of these commentators recommended that the final rule limit the derivatives of columbite-tantalite, cassiterite, and wolframite to tantalum, tin, and tungsten, respectively,[65] unless the State Department determines subsequently that additional specific minerals or their derivatives are financing or benefitting armed groups.[66] One of these commentators pointed out that such a limit is appropriate because, although conflict minerals have other derivatives, tantalum, tin, and tungsten are the only economically significant derivatives of the conflict minerals.[67] For example, one commentator noted that oxygen and iron are derivatives of wolframite that could be subject to the final rule, but wolframite is not

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[63] Tungsten Statistics and Information, U.S. GEOLOGICAL SURVEY, available at http://minerals.usgs.gov/minerals/pubs/commodity/tungsten.

[64] See, e.g., letters from American AAFA, Global Tungsten & Powders Corp. (Mar. 1, 2011) ("Global Tungsten I"), Industry Group Coalition I, IPC I, IPC – Association Connecting Electronics Industries (Nov. 1, 2011) ("IPC II"), Materion Corporation (Nov. 1, 2011) ("Materion"), National Retail Federation (Nov. 1, 2011) ("NRF II"), PCP, Robert W. Row (Jan. 18, 2011) ("Row"), SEMI, and Society of the Plastics Industry Inc. (Nov. 9, 2011) ("SPI").

[65] Gold is produced in its metallic form and has no derivatives.

[66] See, e.g., letters from AAFA, IPC II, NRF II, PCP, and SPI.

[67] See letters from IPC II and NRF II. See also Transcript of SEC Roundtable, Section 0039 Lines 9-10 ("MR. MATHESON: The economic interest is in the three Ts plus gold.").

currently a significant commercial source for oxygen or iron.[68] Another commentator noted that niobium is a derivative of columbite-tantalite that, absent clarification to the contrary, could be subject to the final rule as well.[69] Some commentators, however, asserted that that the final rule should not solely be limited to tantalum, tin, tungsten, or gold.[70]

One commentator recommended that the definition of "conflict mineral" not include organic metal compounds formed from a conflict mineral metal derivative, such as tin and tungsten, because these substances are no longer metals or alloys and "use of these chemical compounds is too attenuated from the original source of the mineral."[71] According to the commentator, these organometallic compounds, which include catalysts, stabilizers, and polymerization aids, are commodity chemicals used in the production of raw materials such as silicones, polyurethanes, vinyls, and polyesters. For example, the commentator noted that tin is used in a reaction with chlorine gas, after which the intermediate tin tetrachloride compound undergoes further chemical reactions with any number of organic substrates to produce an organotin compound with the final compounds becoming substances such as stannous octoate, monobutyl tin trichloride, and dioctyltin dilaurate. These substances contain tin but have several organic groups chemically bound to the tin nucleus and are compounds that are materially and

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[68] See letter from SEMI.

[69] See letter from Row.

[70] See, e.g., letters from BC Investment Management Corporation (Mar. 28, 2011) ("BCIMC") and Save the Congo (Nov. 1, 2011) ("Save").

[71] See letter from SPI.

chemically distinct from metallic tin. According to the commentator, the use of organotin in many manufacturing sectors has not yet been recognized by manufacturers, supply chains, or regulators, which may increase costs of the final rule if organic tin compounds are included in the definition of "conflict minerals."

In addition, a number of commentators recommended that the final rule selectively use the term "conflict mineral" because not doing so would unfairly stigmatize the four minerals and unjustifiably hurt some companies' reputations.[72] These commentators noted that the term "conflict mineral" in the proposed rules provides no clear distinction between the four named minerals and their derivatives that did not benefit or finance armed groups, and those that did finance or benefit armed groups. Specifically, one of these commentators noted, "refer[ring] to all cassiterite, wolframite, gold, and tantalum in the world, regardless of its origin and relationship to conflict actors" as "conflict minerals," imposes "a reputational taint on these entire industries," and "makes it highly challenging for companies in these industries to communicate effectively with investors and the public."[73] Commentators suggested that we limit the final rule's definition of "conflict minerals" only to minerals that financed or benefited

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[72] See, e.g., letters from Advanced Medical Technology Association (Feb. 28, 2011) ("AdvaMed I"), Barrick Gold Corporation (Feb. 28, 2011) ("Barrick Gold"), Cleary Gottlieb Steen & Hamilton LLP (Mar. 2, 2011) ("Cleary Gottlieb"), Global Tungsten I, JVC et al. II, Malaysia Smelting Corporation (Jan. 26, 2011) ("MSC I"), National Association of Manufacturers (Nov. 1, 2011) ("NAM III"), Niotan Inc. (Jan. 30, 2011) ("Niotan I"), Niotan Inc. (Mar. 21, 2011) ("Niotan II"), National Mining Association (Mar. 2, 2011) ("NMA II"), SEMI, Tanzania I, TIC, and WGC II. See also MJB Consulting (Apr. 28, 2011) ("MJB I") (arguing that the Conflict Minerals Statutory Provision is unclear as to whether the definition of "conflict minerals" refers to columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives, per se, originating from the Covered Countries, or columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives originating from the Covered Countries and that do not directly or indirectly finance or benefit armed groups in the Covered Countries).

[73] See letter from Niotan II.

armed groups and that the final rule use another name to describe minerals that did not finance or benefit armed groups, such as "potential conflict minerals," "suspect conflict minerals," "subject minerals," or "covered minerals."[74] Additionally, for the same reasons, some commentators indicated that the final rule should change the names of the required headings from "Conflict Minerals Disclosure" to "Country of Origin Disclosure" and change the name of the Conflict Minerals Report to "Report on Minerals Sourced from Central Africa."[75]

**3. Final Rule**

After considering the comments, we are revising the proposal in the final rule. We are clarifying our position as to which derivatives are conflict minerals, which appears consistent with the views of various stakeholders,[76] including at least one co-

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[74] See letters from Cleary Gottlieb, Niotan II, SEMI, and TIC.

[75] See letters from Barrick Gold and Niotan I.

[76] See, e.g., letter from H.E. Ambassador Liberata Mulamula, International Conference on the Great Lakes Region, Angel Gurría, Secretary-General, Organisation for Economic Co-operation and Development, and Fred Robarts, Coordinator, United Nations Group of Experts on the Democratic Republic of the Congo (Jul. 29, 2011) ("OECD I") ("We consider that the OECD and UN GoE due diligence recommendations, as integrated into the framework of the ICGLR Regional Initiative against the Illegal Exploitation of Natural Resources and the Regional Certification Mechanism, can be used by persons subject to Section 1502 of the Dodd-Frank Act ("issuers") to reliably determine whether the tin, tantalum, tungsten or gold in their products originate from the DRC or adjoining countries, and if so, to determine the facilities used to process those minerals, the country of origin, and the mine or location of origin with the greatest possible specificity, and describe the products manufactured or contracted to be manufactured that are not DRC conflict free."); OECD, DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS, 12 (2011), available at http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/46740847.pdf (discussing due diligence as a basis for responsible global supply chain management of "tin, tantalum, tungsten, their ores and mineral derivates, and gold"); Final Report of the United Nations Group of Experts on the Democratic Republic of the Congo, Nov. 29, 2010 [S/2010/596] (stating that relevant individuals and entities should establish effective systems of control and transparency over the mineral supply chain, the nature of which will vary according to the mineral being traded, with the gold supply chain exhibiting characteristics different to those for tin, tantalum, and tungsten, and according to the position of the individual or entity in the supply chain); Enough Project, From Mine to Mobile Phone: The Conflict Minerals Supply Chain (Nov. 10, 2009) available at http://www.enoughproject.org/files/publications/minetomobile.pdf (indicating its desire to increase

sponsor of the legislation and other members of Congress.[77] As a commentator suggested, our failure in the proposal to specify the 3T derivatives (tantalum, tin, and tungsten, which are known as the "3Ts") would have introduced too much ambiguity in our rule,[78] which would have expanded the Conflict Mineral Provision's reach, cost, and complexity without increasing its effectiveness.[79] The term "conflict mineral" in the final rule is defined to include cassiterite, columbite-tantalite, gold, wolframite, and their

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transparency in the supply chains for tin, tantalum, and tungsten, or the 3Ts, as well as gold, which are key elements of electronics products including cell phones and personal computers and are the principal source of revenue for armed groups and military units that prey on civilians in eastern Congo; and the 3Ts are produced from mineral ores, including tin from cassiterite, tungsten from wolframite, and tantalum from columbite-tantalite, known throughout Congo as coltan); and Global Witness, Do No Harm: Excluding conflict minerals from the supply chain, 2 (July 2010), available at http://www.globalwitness.org/sites/default/files/pdfs/do_no_harm_global_witness.pdf (stating that "the warring parties [in the DRC] finance themselves via control of most of the mines in [eastern DRC] that produce tin, tantalum and tungsten ores and gold"). See also State Department, Statement Concerning Implementation of Section 1502 of the Dodd-Frank Legislation Concerning Conflict Minerals Due Diligence, 1 (July 15, 2011), available at http://www.state.gov/documents/organization/168851.pdf (noting that the State Department "is undertaking a number of actions to address the problem of conflict minerals – or the exploitation and trade of gold, columbite-tantalite (coltan), cassiterite (tin), wolframite (tungsten), or their derivatives – sourced from the eastern" DRC that have "helped to fuel the conflict in the eastern DRC").

[77] See letters from Representative Mark E. Amodei (Dec. 20, 2011) ("Rep. Amodei") (referring to "tungsten"); Representatives Howard L. Berman, Donald M. Payne, and Christopher H. Smith (Nov. 8, 2010) (Pre-Proposing Release website) ("Rep. Berman et al. pre-proposing") ("Section 1502 was designed to limit the ability of armed groups in the Democratic Republic of Congo (DRC) to profit from the illicit mining of tin ore, coltan, gold, and other mineral resources that eventually end up in computers, cell phones, and other products."); Representatives Howard L. Berman, Donald M. Payne, Jim McDermott, Karen Bass, and Barney Frank (Sep. 23, 2011) ("Rep. Berman et al."); Representative Renee L. Ellmers (Dec. 13, 2011) ("Rep. Ellmers") (referring to "tungsten"); Rep. Lee (referring to gold, tin, tantalum, and tungsten as "conflict minerals," by stating that "[f]or years, minerals such as gold and other raw materials commonly used to produce tin, tantalum, and tungsten have been mined and sold illegally by rebel groups in parts of the Democratic Republic of the Congo (DRC) and neighboring countries," and that "[t]hese 'conflict minerals' have fueled decades of fighting in central Africa."); Representative Tim Murphy (Dec. 29, 2011) ("Rep. Murphy") (referring to "tungsten"); and Senator Barbara Boxer, Senator John Boozman, Senator Christopher A. Coons, Senator Patrick J. Leahy, Senator Frank R. Lautenberg, and Senator Jeff Merkley (Oct. 18, 201) ("Sen. Boxer et al. I") ("The purpose of Sec. 1502 is to create transparency and accountability in the mineral supply chain in the DRC. Minerals from the DRC – which include tin, tantalum, tungsten and gold – are commonly used in products such as cellphones, laptops and jewelry.").

[78] See letter from SEMI.

[79] See letters from IPC II and NRF II.

derivatives, which are limited to the 3Ts, unless the Secretary of State determines that additional derivatives are financing conflict in the Covered Countries, in which case they are also considered "conflict minerals;" or any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the Covered Countries.

Additionally, despite the suggestion by certain commentators that we limit the definition of the term "conflict mineral" to minerals that financed or benefited armed groups, the final rule continues to use the term "conflict mineral" to refer to columbite-tantalite, cassiterite, gold, wolframite, and their derivatives, and any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the Covered Countries whether or not they actually financed or benefited armed groups. We believe this approach is appropriate because it is consistent with the use of that term in the Conflict Minerals Statutory Provision and to change the definition of the term for the final rule could cause confusion among interested parties between the use of the term in the statutory provision and the use of the term in the final rule. However, issuers whose conflict minerals did not finance or benefit armed groups may describe their products containing those minerals as "DRC conflict free" in their specialized disclosure report, provided that the issuer is able to determine on the basis of due diligence conducted in accordance with a nationally or internationally recognized due diligence framework that such products are "DRC conflict free" as defined in the final rule.

## B. Step One – Issuers Covered by the Conflict Mineral Provision

### 1. Issuers That File Reports Under the Exchange Act

#### a. Proposed Rules

As we discussed in the Proposing Release, we recognize there is some ambiguity as to whom the Conflict Minerals Statutory Provision applies given that the provision states that the Commission shall promulgate regulations for any "person described"[80] and that a "person is described" if "conflict minerals are necessary to the functionality or production of a product manufactured by such person."[81] Therefore, the Conflict Minerals Statutory Provision could be interpreted to apply to a wide range of private companies not previously subject to our disclosure and reporting rules. Given the provision's legislative background, its statutory location, and the absence of Congressional direction to apply the provision to companies not previously subject to those rules,[82] however, we believe the more appropriate interpretation is that the rules apply only to issuers that file reports with the Commission under Section 13(a) or Section 15(d) of the Exchange Act, and that is what we proposed.[83] Also, consistent with the statutory language, our proposed rules would have applied equally to domestic companies, foreign private issuers, and smaller reporting companies.

#### b. Comments on the Proposed Rules

##### i. Issuers that File Reports Under Sections 13(a)

[80] See Exchange Act Section 13(p)(1)(A).

[81] See Exchange Act Section 13(p)(2)(B).

[82] See H.R. REP. No. 111-517, Joint Explanatory Statement of the Committee of Conference, Title XV, "Conflict Minerals," at 879 (Conf. Rep.) (June 29, 2010) ("The conference report requires disclosure to the SEC by all persons otherwise required to file with the SEC for whom minerals originating in the Democratic Republic of Congo and adjoining countries are necessary to the functionality or production of a product manufactured by such person.").

[83] Exchange Act Section 13(a) requires issuers with classes of securities registered under Exchange Act Section 12 [15 U.S.C. 78l] to file periodic and other reports. See 15 U.S.C. 78m. Exchange Act Section 15(d) requires issuers with effective registration statements under the Securities Act of 1933 (the "Securities Act") to file reports similar to Exchange Act Section 13(a) for the fiscal year within which such registration statement became effective. See 15 U.S.C. 78n. Therefore, if our proposed rules did not include issuers required to file reports under Exchange Act Section 15(d), some issuers who file annual reports may not otherwise be required to comply with our proposed conflict minerals rules.

**and 15(d) of the Exchange Act**

Many commentators addressing the issue agreed with the proposal that the final rule should apply to issuers that file reports under Sections 13(a) and 15(d) of the Exchange Act and not to private companies or individuals.[84] Some of these and other commentators acknowledged, however, that not including individuals and private companies in the final rule could unfairly burden Sections 13(a) and 15(d) issuers and put them at a competitive disadvantage by increasing their costs.[85] On the other hand, some of these commentators noted that not including private companies and individuals in the final rule may not unduly burden Sections 13(a) and 15(d) issuers because the commercial pressure on private companies by issuers that need this information for their reports and by the public in general demanding that issuers make this information available could be sufficient enough for the private companies to provide voluntarily their conflict minerals information as standard practice.[86] Another commentator argued that

[84] See, e.g., letters from AngloGold; Arkema, Inc. (Mar. 1, 2011) ("Arkema"); Calvert; Cleary Gottlieb; Communications and Information Network Association of Japan, Japan Auto Parts Industries Association, Japan Business Machine and Information System Industries Association, Japan Electronics and Information Technology Industries Association, The Japan Electrical Manufacturers' Association, Japan Machinery Center for Trade and Investment (Mar. 2, 2011) ("Japanese Trade Associations"); CRS I; Earthworks; Howland; IPC I; JVC et al. II; KEMET Corporation (Nov. 1, 2011) ("Kemet"); PCP; Rockefeller Financial Asset Management (Mar. 1, 2011) ("Rockefeller"); SIF I; State II; TIC; and TriQuint I.

[85] See, e.g., letters from Howland, IPC I, ITIC I, NMA II, National Retail Federation (Mar. 2, 2011) ("NRF I"); TIC; and TriQuint I.

[86] Letter from Howland (noting that "private companies (non reporters) will likely need to provide the same [conflict minerals] information to their customers who will need the information for their reports;" and that providing conflict minerals information is "likely" to "become a de facto standard similar to RoHS (EU Restriction of hazardous Substances) for electronics") and TIC ("Further, provided that the regulations apply to large and small issuers, they will form a critical mass which will, in practice, create sufficient commercial pressure on private companies and individuals who manufacture products involving potential conflict materials. Noncompliant companies will be unable to withstand the political and consumer pressures. Accordingly, there is no need for the SEC to seek to expand its jurisdiction.").

the effects of the final rule on competition "are likely to be benign."[87] This commentator asserted that "conflict minerals disclosure costs will not increase the cost of being a publicly traded company by a significant percentage" and that being able to declare a company's products as "DRC conflict free" could become a competitive advantage.[88] Further, in response to our request for comment in the Proposing Release, all four commentators that discussed the issue agreed that an issuer with a class of securities exempt from Exchange Act registration pursuant to Exchange Act Rule 12g3-2(b)[89] should not be subject to the final rule.[90] One commentator recommended "that entities with Over-The-Counter American Depository Receipts (OTC ADRS) that file an annual report with the SEC should also be required to file a 'Conflict Minerals Disclosure' report."[91]

Some commentators stated that the final rule should not necessarily require private companies to submit to us their conflict minerals information, but the final rule should provide mechanisms that allow private companies to report voluntarily on their conflict minerals in a manner similar to Sections 13(a) and 15(d) issuers,[92] which could include working with other agencies that regulate non-reporting companies to have those

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[87] See letter from Green II.

[88] Id.

[89] 17 CFR 240.12g3-2(b).

[90] See Cleary Gottlieb, JVC et al. II, New York State Bar Association (Mar. 1, 2011) ("NY State Bar"), and SIF I.

[91] See letter from Calvert.

[92] See letters from Earthworks and TriQuint I.

agencies require their filers to provide similar conflict minerals information.[93] Moreover, the State Department commented that it would encourage private companies not subject to the final rule to disclose voluntarily conflict minerals information.[94] Other commentators disagreed with the proposed rules and indicated that the final rule should apply to more than just issuers that file reports under Sections 13(a) and 15(d) of the Exchange Act.[95] A comment letter submitted jointly by two of the co-sponsors of the legislation stated that their "intent was for the requirements of Section 1502 to apply to all companies that fall under the jurisdiction of the SEC, including those who issue classes of securities otherwise exempt from reporting."[96]

**ii. Smaller Reporting Companies**

Many commentators agreed that the final rule, as we proposed, should not exempt smaller reporting companies.[97] In this regard, one commentator noted that, although there would be additional costs for smaller reporting companies to comply with the rules, the increased costs will apply also to larger companies.[98] Another commentator asserted that compliance costs for small issuers "will be relatively modest" due to their smaller

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[93] See letter from TriQuint I.

[94] See letter from State II.

[95] See, e.g., letters from Catholic Charities Diocese of Houma-Thibodaux (Apr. 21, 2011) ("Catholic Charities"), International Corporate Accountability Roundtable and Global Witness (Nov. 1, 2011) ("ICAR et al. II"), ITIC I, NRF I, Sen. Durbin / Rep. McDermott, Sisters of Good Shepherd (Apr. 8, 2011) ("Good Shepherd"), TIC, and Tiffany.

[96] See letter from Sen. Durbin / Rep. McDermott.

[97] See, e.g., letters from BCIMC, Calvert, CRS I, Earthworks, Global Witness I, Howland, IPC I, JVC et al. II, Rockefeller, Sen. Durbin / Rep. McDermott, SIF I, State II, TIAA-CREF, TIC, and TriQuint I.

[98] See letter from Howland.

scale and lower complexity of their businesses.[99] One commentator did not believe that the proposed rules would impose higher costs on smaller companies significant enough to justify an exemption because smaller reporting companies would have fewer products to track than a larger company, which would decrease their compliance costs.[100] The commentator based its belief on the fact that, although it was a small human rights group with a modest budget, it regularly undertakes field investigations and supply chain research that is very similar to the due diligence measures it recommended the Commission adopt. According to this commentator, if it is able to perform due diligence with a small staff, so too can a smaller reporting company.

Some commentators noted that exempting smaller reporting companies from the final rule could increase the burdens on larger reporting companies because the larger reporting companies may be less able to require their smaller reporting company suppliers to provide the conflict minerals information needed by the larger reporting companies.[101] One of these commentators noted also that permitting limited disclosure and reporting obligations for smaller companies is unlikely to reduce significantly their burdens because larger companies would likely impose contractual obligations on them to track and provide their conflict minerals information for the larger companies.[102]

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[99] See letter from Green II. See also letter from ICAR et al. II (stating that "because these issuers are smaller, it stands to reason that they will have fewer products that contain conflict minerals, thus reducing the amount of products that must undergo a reasonable country of origin inquiry and supply chain due diligence").

[100] See letter from Global Witness I.

[101] See, e.g., letters from IPC I and TriQuint I.

[102] See letters from IPC I.

Other commentators supported exempting smaller reporting companies because these companies would be less able to compel their suppliers to provide conflict minerals information due to their lack of leverage,[103] and because it would be more expensive for smaller reporting companies to comply with the rule relative to their revenues than for other companies.[104] However, one commentator argued that, although such issuers may lack leverage, this disadvantage may be reduced through the influence exerted over their suppliers by larger issuers that use the same supplier base and that have more leverage to request such information.[105] Some commentators argued that smaller reporting companies should be allowed to phase-in the rules or that the implementation date of the final rule should be deferred for them.[106]

iii. **Foreign Private Issuers**

A number of commentators believed that the final rule should not exempt foreign private issuers.[107] As one commentator noted,[108] exempting foreign private issuers from the final rule could increase domestic issuers' burdens by making it very difficult for them to compel their foreign private issuer suppliers to provide conflict minerals

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[103] See, e.g., letters from ABA, JVC et al. II, and Society of Corporate Secretaries and Governance Professionals (Mar. 3, 2011) ("Corporate Secretaries I").

[104] See letter from Corporate Secretaries I and Howland.

[105] See letter from Green II.

[106] See, e.g., letters from ABA, Howland, and JVC et al. II.

[107] See, e.g., letters from AngloGold, BCIMC, Calvert, CRS I, Earthworks, Global Witness I, Howland, JVC et al. II, NEI Investments (Mar. 2, 2011) ("NEI"), NY State Bar, SIF I, State II, TIAA-CREF, TriQuint I, WGC II, and WLF.

[108] See letter from TriQuint I.

information. As another commentator noted,[109] exempting foreign private issuers from the final rule could also result in a competitive disadvantage for domestic issuers because foreign private issuers would not be subject to the final rule. Further, this commentator indicated that not exempting foreign private issuers could actually motivate foreign companies to advocate for similar conflict minerals regulations in their home jurisdictions to reduce any competitive disadvantages they may have with companies from their jurisdictions that do not register with us. Finally, the commentator suggested that exempting foreign private issuers may hurt conflict minerals supply chain transparency, which would be contrary to the intent of Congress.

Only one commentator, a foreign private issuer, stated specifically that foreign private issuers should be exempt from the final rule.[110] This commentator argued that any Congressional intent to give laws extraterritorial effect must be clearly expressed and stated, which the Conflict Minerals Statutory Provision fails to do. Also, the commentator noted that the proposed rules would violate international principles of diplomatic comity and could put diplomats from countries with foreign private issuers in jeopardy. Another commentator suggested that, if the final rule would cause "more than an insignificant number of foreign private issuers to leave the U.S. markets or not to enter the U.S. markets," we should consider exempting all or some foreign private issuers from the final rule.[111] A further commentator stated that, although it recommended that the final rule not exempt foreign private issuers, it expects that the final rule "will represent

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[109] See letter from NEI.

[110] See letter from Taiwan Semi.

[111] See letter from ABA.

just one more strong disincentive for such issuers to access the U.S. markets."[112]

#### c. Final Rule

After considering the comments, we are adopting the final rule as proposed. Therefore, the final rule applies to any issuer that files reports with the Commission under Section 13(a) or Section 15(d) of the Exchange Act, including domestic companies, foreign private issuers, and smaller reporting companies. We believe the statutory language is clear on this point and believe that it only applies to issuers that file reports with the Commission under Section 13(a) or Section 15(d) of the Exchange Act. There is no clear indication that Congress intended to cover issuers other than those that file such reports. Although we appreciate the views expressed in the comment letter submitted jointly by two of the co-sponsors of the legislation,[113] the legislative history only refers to companies that file with or report to the Commission or that are listed on a United States stock exchange.[114] The location of the statute adopted by Congress in the section of the Exchange Act dealing with reporting issuers reflects a more limited scope, as well.[115]

The statute is silent with respect to any distinction among issuers based on the

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[112] See letter from NY State Bar.

[113] See letter from Sen. Durbin / Rep. McDermott.

[114] See H.R. REP. No. 111-517, Joint Explanatory Statement of the Committee of Conference, Title XV, "Conflict Minerals," at 879 (Conf. Rep.) (June 29, 2010) ("The conference report requires disclosure to the SEC by all persons otherwise required to file with the SEC for whom minerals originating in the Democratic Republic of Congo and adjoining countries are necessary to the functionality or production of a product manufactured by such person."); 156 CONG. REC. S3976 (daily ed. May 19, 2010) (statement of Sen. Feingold) (stating that the "Brownback amendment was narrowly crafted" and, in discussing the provision, referring only to "companies on the U.S. stock exchanges"); 156 CONG. REC. S3865-66 (daily ed. May 18, 2010) (stating that the Conflict Minerals Statutory Provision "is a narrow SEC reporting requirement" and referring only to "SEC reporting requirements" in discussing the provision); and 156 Cong. Rec. S3816-17 (daily ed. May 17, 2010) (statement of Sen. Durbin) (stating that the provision "would require companies listed on the New York Stock Exchange to disclose in their SEC filings").

[115] See Exchange Act Section 13 entitled "Periodical and Other Reports."

issuer's size or domesticity. Although not specifically in the context of smaller reporting companies or foreign private issuers, some commentators suggested that we use our general exemptive authority under Exchange Act Section 36(a)[116] to exempt certain classes of companies from full and immediate compliance with the disclosures required by the Conflict Minerals Statutory Provision.[117] The only limiting factor in the Conflict Minerals Statutory Provision itself as to the type of issuer to which it applies is based on whether conflict minerals are "necessary to the functionality or production" of products manufactured or contracted by the issuer to be manufactured.[118] Moreover, Congress included a specific provision for Commission revisions and waivers to the reporting obligation that requires the President to determine such waiver or revision to be in the national security interest and limits such a Commission exemption to two years. In our view, the high standard set for this statutory waiver, as well as its limited duration, evinces a congressional intent for the Conflict Minerals Statutory Provision to apply broadly and exempting large categories of issuers would be inconsistent with this intent. We also recognize that section 1502 is not simply a disclosure obligation for issuers, but a comprehensive legislative scheme that contemplates coordinated action by a number of federal agencies aimed at making public information about conflict minerals from the

[116] 15 U.S.C. 78mm(a) ("[T]he Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this chapter or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.").

[117] See, e.g., letters from Davis Polk & Wardwell LLP (Mar. 2, 2011) ("Davis Polk"); National Cable & Telecommunications Association (Oct. 31, 2011) ("NCTA"); Representatives Spencer Bachus, Gary G. Miller, Chairman, Robert J. Dold, and Steve Stivers (Jul. 28, 2011) ("Rep. Bachus et al."); Verizon; and Wilmer Cutler Pickering Hale and Dorr LLP Hale on behalf of IPC (Jun. 2, 2011) ("WilmerHale").

[118] Exchange Act Section 13(p)(2)(B).

Covered Countries.[119] We are concerned that any broad categories of exemptions would be inconsistent with this scheme and the statutory objective of reducing the use of conflict minerals from the Covered Countries that contribute to conflict.[120] Congress chose to pursue this goal through the implementation of a comprehensive disclosure regime. In order to allow the provision to have the effect we understand Congress intended, we believe our rules must be consistent with the statutory language and not exempt broad categories of issuers from its application. Thus, we are not exempting smaller reporting companies or foreign private issuers.

Additionally, it is unclear whether exempting smaller reporting companies in particular would significantly reduce their burdens because smaller reporting companies could still be required to track and provide their conflict minerals information for larger issuers.[121] Moreover, to the extent there are benefits to smaller companies from an

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[119] Sections 1502(c) and (d) of the Act. We recognize that Congress also required the Comptroller General to periodically report on, among other things, publicly available information regarding persons who are "not required to file reports . . . pursuant to Section 13(p)(1)(A)" and who manufacture products for which "conflict minerals are necessary to the functionality or production." Section 1502(d)(2)(C). We interpret this provision to require reporting by the Comptroller General on persons -- such as private companies not subject to our disclosure and reporting rules -- who are not subject to the requirements of the Conflict Minerals Statutory Provision even though conflict minerals may be necessary to the functionality or production of their products. Any issuers that receive waivers or revisions pursuant to Section 13(p)(3) would also be included.

[120] See letters from Global Witness I and State II and Transcript of SEC Roundtable on Conflict Minerals, Section 141 (Oct. 18, 2011) (Statement of Tim Mohin), available at http://www.sec.gov/spotlight/conflictminerals/conflictmineralsroundtable101811-transcript.txt (stating that although no single company working alone can determine whether minerals in its products supported armed groups, large and small companies working together can make such a determination), id. at 22 (Statement of Bennett Freeman) (arguing that all companies across the value and supply chain should be covered by the rule because disclosures by all companies are important to investors). See also id. at 62, 92, and 103 (Statements of Andrew Matheson, Benedict S. Cohen, and Representative James McDermott, respectively) (assuming that small issuers would be covered by the rule).

[121] See letters from IPC I.

exemption, such an exemption could increase the burden on larger companies that rely on smaller reporting company suppliers to provide conflict minerals information needed by the larger reporting companies.

Further, as discussed in greater detail below, the final rule temporarily will permit all issuers that are unable to determine that their conflict minerals did not originate in the Covered Countries or that are unable to determine that their conflict minerals that originated in the Covered Countries did not directly or indirectly finance or benefit armed groups to describe their products as "DRC conflict undeterminable," and temporarily will not require such issuers to obtain an independent private sector audit of their Conflict Minerals Report with respect to those minerals. This temporary accommodation will be available to all issuers for the first two years of reporting under the final rule. The final rule extends that period for smaller reporting companies for an additional two years, providing a temporary four-year provision for smaller reporting companies. This approach is consistent with some commentators' recommendations as to the applicability of the reporting requirement to smaller reporting companies.[122]

Similarly, we are not exempting foreign private issuers because we do not believe that it would give effect to Congressional intent of the provision. As commentators

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[122] See letter from Howland (stating that, although "[t]here will be additional costs that may be proportionally higher for small companies, but increased costs will also apply to large firms," a way that the final rule can "mitigate the cost is to phase in the acceptable level of rigor for due diligence over several years and based on company size"). See also letter from JVC et al. II (stating that, "[w]ith respect to smaller reporting companies, it is reasonable to assume that the costs of compliance may disproportionately harm them by comparison with any concomitant benefit in achieving the statutory goals, since these companies lack the leverage to pressure suppliers and smelters to certify regarding the source of a particular conflict mineral," so "we believe it would be appropriate to allow smaller reporting companies even more time in which to adapt the results of these broader global initiatives to their individual facts and circumstances").

noted, exempting foreign private issuers could make it difficult for issuers to compel their foreign private issuer suppliers to provide conflict minerals information, result in a competitive disadvantage for domestic issuers, and hurt conflict minerals supply chain transparency.[123] Also, we note that including foreign private issuers in the final rule does not give the Conflict Minerals Statutory Provision an extraterritorial effect because it applies only to foreign private issuers that enter the securities markets of the United States.

### 2. "Manufacture" and "Contract to Manufacture" Products

#### a. Proposed Rules

The Conflict Minerals Statutory Provision applies to any person for whom conflict minerals are necessary to the functionality or production of a product manufactured by that person. The proposed rules would likewise have applied to reporting persons for whom conflict minerals are necessary to the functionality or production of products they manufacture. We did not define the term "manufacture" in the proposed rules, because we believed the term to be generally understood.[124]

In addition, based on the text of the Conflict Minerals Statutory Provision as well as statutory intent, the proposed rules would also have applied to issuers that contract to manufacture products. As discussed in the Proposing Release, one section of the Conflict Minerals Statutory Provision defines a "person described" as one for which conflict

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[123] See letters from NEI and TriQuint I.

[124] For example, the Second Edition of the Random House Webster's Dictionary defines the term to include the "making goods or wares by hand or machinery, esp. on a large scale." RANDOM HOUSE WEBSTER'S DICTIONARY 403 (2d ed. 1996).

minerals are "necessary to the functionality or production of a product manufactured by such a person;"[125] while another section of the provision requires an issuer to describe "the products manufactured or <u>contracted to be manufactured</u> that are not DRC conflict free" [emphasis added] in its Conflict Mineral Report.[126] The absence of the phrase "contract to manufacture" from the "person described" definition raised some question as to whether the requirements apply equally to those who manufacture products themselves and those who contract to have their products manufactured by others. Based on the totality of the provision, however, we expressed in the Proposing Release our belief that the legislative intent was for the provision to apply both to issuers that directly manufacture products and to issuers that contract the manufacturing of their products for which conflict minerals are necessary to the functionality or production of those products. The proposed rules, therefore, would have applied equally to issuers that manufacture products and to issuers that "contract to manufacture" their products. We noted that this approach would allow the "contracted to be manufactured" language to have effect in the Conflict Minerals Report.

In the Proposing Release, we explained that the proposed rules would apply to issuers that contract for the manufacturing of products over which they had any influence regarding the manufacturing of those products. As proposed, they also would have applied to issuers selling generic products under their own brand name or a separate brand name that they had established, regardless of whether those issuers had any

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[125] Exchange Act Section 13(p)(2)(B).

[126] Exchange Act Section 13(p)(1)(A)(ii).

influence over the manufacturing specifications of those products, as long as an issuer had contracted with another party to have the product manufactured specifically for that issuer. We did not, however, propose that the rules would apply to retail issuers that sell only the products of third parties if those retailers had no contract or other involvement regarding the manufacturing of those products, or if those retailers did not sell those products under their brand name or a separate brand they had established and did not have those products manufactured specifically for them.

#### b. Comments on the Proposed Rules

##### i. "Manufacture"

Many commentators agreed with the proposed rules that the final rule should not define the term "manufacture" because that term is generally understood.[127] Many other commentators, however, believed that the final rule should define the term,[128] and most of these commentators provided their recommendations for the definition. A number of commentators indicated that the definition should mirror the North American Industry Classification System ("NAICS"),[129] which classifies entities as manufacturers if they engage in the mechanical, physical, or chemical transformation of materials, substances,

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[127] See, e.g., letters from ABA, Global Witness I, Howland, NYCBar I, NYCBar II, State II, TIC, and United States Steel Corporation (Mar. 4, 2011) ("US Steel").

[128] See, e.g., letters from American Association of Exporters and Importers (Jan. 21, 2011) ("AAEI"); AngloGold; Columban Center for Advocacy and Outreach, Leadership Conference of Women Religious, Sisters of Mercy of the Americas – Institute Justice Team, Missionary Oblates, and Maryknoll Office for Global Concerns (Mar. 2, 2011) ("Columban Center et al."); CTIA – The Wireless Association (Mar. 1, 2011) ("CTIA"); Earthworks; Enough Project I; International Corporate Accountability Roundtable, Enough Project, and Global Witness (Sep. 23, 2011) ("ICAR et al. I"); Metalsmiths; NAM I; NEI; NMA II; RILA-CERC; SIF I; TriQuint I; and WGC II.

[129] See letters from AAEI, AngloGold, BCE Inc. (Oct. 31, 2011) ("BCE"), Canadian Wireless Telecommunications Association (Oct. 28, 2011) ("CWTA"), CTIA, NAM I, NCTA, NMA II, RILA-CERC, and WGC II.

or components into new products from raw materials that are products of agriculture, forestry, fishing, mining, or quarrying.

Some commentators stated that the final rule should define the term inclusively or broadly so as to include all steps in the supply chain, from mining to manufacturing the product, because otherwise it would become exponentially more difficult for manufacturing issuers downstream in the supply chain to comply with the final rule.[130] One commentator indicated that the term should include all steps from mining, refining, and production to the importing, exporting, or sale of ingredients, materials, and/or processes.[131] A few commentators indicated that the final rule should provide a definition consistent with the U.S. Controlled Substances Act, which includes the production, preparation, assembling, propagation, combination, compounding, or processing of a drug or other substance, either directly or indirectly or by extraction from substances of natural origin.[132] One of these commentators stated that such a consistent definition would include the "production, preparation, assembling, combination, compounding, or processing of ingredients, materials, and/or processes such that the final product has a name, character, and use, distinct from the original ingredients, materials, and/or processes."[133] One commentator asserted that the definition should include any

[130] See letters from Columban Center et al., Metalsmiths, and TriQuint I.

[131] See letter from Earthworks.

[132] See letters from Enough Project I and SIF I.

[133] See letter from Enough Project I (citing to its earlier letter submitted Sep. 24, 2010 on the Pre-Proposing Release website).

entity "involved in the process of changing a product…from one form to another."[134] One commentator suggested that the definition "should be tailored only to include OEM's and those who design and specify bills of materials for products with control over the procurement or fabrication of the same products' bill of materials and specification of the constituent materials of the components."[135] One commentator urged us to provide clear guidance indicating that real estate development does not constitute manufacturing.[136]

**ii. "Contract to Manufacture"**

Not all commentators agreed on whether the final rule should include an issuer that contracts to manufacture a product. However, many commentators that agreed that the final rule should include an issuer that contracts to manufacture a product, or did not agree but argued in the alternative, recommended that an issuer should be required to have some amount of control or influence over the manufacturing process before the final rule considers that issuer to be contracting to manufacture a product.[137] A number of commentators suggested the level of control necessary to be considered contracting to manufacture a product under the final rule. In this regard, some commentators suggested that only an issuer with direct, close, active, and/or substantial involvement or control in

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[134] See letter from Jeffrey Trott (Jan. 31, 2011) ("Trott").

[135] See letter from Retail Industry Leaders Association (Nov. 1, 2011) ("RILA").

[136] See letter from National Association of Real Estate Investment Trusts (Nov. 23, 2011) ("NAREIT").

[137] See, e.g., letters from AdvaMed I, AT&T Inc. (Mar. 9, 2011) ("AT&T"), Chamber I, Cleary Gottlieb, Consumer Electronics Retailers Coalition (Nov. 1, 2011) ("CERC"), Industry Group Coalition I, IPC I, IPC II, JVC et al. II, NAM I, NCTA, Niotan I, NMA II, NRF I, NRF II, PCP, RILA, Roundtable, SEMI, TIAA-CREF, and TriQuint I.

the sourcing of materials, parts, ingredients, or components to be included in its products or in the manufacturing of those products should meet the minimum control threshold necessary to be considered contracting to manufacture a product.[138] One commentator recommended that an issuer should be considered to be contracting to manufacture a product only if it exercises "a sufficient level of influence, involvement or control over the process to be able to control, in a meaningful manner, the use of conflict minerals, or to evaluate and influence the use of conflict minerals."[139] Some commentators asserted that the minimum control threshold should be met only if the issuer explicitly specifies the inclusion of conflict minerals in the product.[140] Another commentator advised that the contracting activities that should trigger conflict minerals reporting should include designing the product, controlling the approved materials or vendor lists for the product, and including the issuer's name on the product.[141]

Some of these commentators, as well as others, asserted that an issuer should not be considered to meet the control threshold to the extent that the product is not manufactured to meet an issuer's custom specifications, but rather is manufactured to meet industry-standard specifications common to the issuer's competitors generally.[142] For example, a group of jewelry industry commentators argued in one letter that a jewelry retail issuer ordering products from jewelry manufacturers should not be

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[138] See letters from AT&T, CERC, Corporate Secretaries I, CTIA, JVC et al. II, NCTA, NRF I, RILA, and Verizon.

[139] See letter from ABA.

[140] See letters from NAM I and SEMI.

[141] See letter from TriQuint I.

[142] See letters from AngloGold, AT&T, BCE, JVC et al. II, NCTA, and RILA-CERC.

considered contracting to manufacture for those products if the retail issuer specifies only weight, karat, or other indicators of quality.[143] As another example, a mobile phone service provider asserted that it should not be considered contracting to manufacture its mobile phones even though it specifies to its manufacturers that the phones must be compatible with their networks and have certain cosmetic design requirements.[144]

Some commentators suggested that the final rule should not consider an issuer to be contracting to manufacture products if the issuer is selling products under its own brands, labels, trademarks, or licenses if it had little or no influence in manufacturing those products.[145] Other commentators recommended that the final rule should consider such issuers to be contracting to manufacture those products.[146] One commentator asserted that generic products should be held to the same standard as branded products and that the final rule should avoid using any definitions that create a perverse incentive for an issuer to work with special purpose entities designed to follow the technical requirements of the law but evade its intent.[147] Another commentator suggested that the final rule should apply to issuers selling generic products under their own name or a

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143 See letter from JVC et al. II.

144 See letter from AT&T. See also letter from BCE (stating that the commentator, a distributor of a wide range of telecommunications and electronic products supplied by hundreds of manufacturers, "exerts no substantial control over the design or the technical features of those products or any control, direct or indirect, over the supply chains, which may be quite complex, of such manufacturers," and its "sole input into the manufacturing process relates to providing brand name manufacturers with certain technical specifications to ensure compliance with applicable Canadian regulatory standards or to requesting special product features, cosmetic in nature, to meet Canadian consumer market demands").

145 See letters from AT&T, BCE, Cleary Gottlieb, CTIA, Industry Group Coalition I, JVC et al. II, NAM I, NCTA, and NRF I.

146 See letters from Enough Project I, Howland, NEI, SIF I, State II, and TriQuint I.

147 See letter from AxamTrade (Feb. 10, 2011) ("Axam").

separate brand name, but not to retailers who do not do so and have no influence over the manufacturing of products they sell.[148]

Some commentators recommended that an issuer should be considered to be contracting to manufacture a product only if the issuer has a direct contractual relationship with the manufacturer of the product to be sold by the issuer, the issuer has substantial control over the manufacturer and the material specifications of the product and specifies the conflict minerals to be used in the product, the product will be manufactured exclusively for the issuer, and 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.[149] One of these commentators went on to assert that an issuer should not be considered to be exerting "substantial control" over manufacturing by "merely attaching a brand label to a generic good, contracting for the exclusive distribution of goods, or specifying the form, fit or function of a product," and should not be considered to be contracting to manufacture a product solely by "attaching a brand label to a generic good, contracting for the exclusive distribution of goods, or specifying the form, fit or function of a product."[150]

Other commentators stressed that the final rule should not apply to any issuer contracting to manufacture its products.[151] These commentators argued generally that the

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[148] See letter from NYCBar II.

[149] See letters from CERC and RILA.

[150] See letter from RILA.

[151] See, e.g., letters from BCE, CERC, CTIA, Davis Polk, NCTA, RILA-CERC, TIC, and United States Telecom Association (Mar. 2, 2011) ("US Telecom").

statute does not include an issuer that contracts to manufacture its products because the phrase does not appear in the subsection of the Conflict Minerals Statutory Provision discussing a "person described." Instead, the phrase appears only in the subsection that describes the disclosures required in a Conflict Minerals Report. Therefore, Congress's intent in including the phrase was only to ensure that a manufacturer otherwise subject to the Conflict Minerals Statutory Provision could not intentionally evade its reporting obligation merely by distancing itself, through contracting, from the manufacturing process.[152]

**c. Final Rule**

**i. "Manufacture"**

After considering the comments, we are modifying the proposed rules, in part. The final rule, as proposed, applies to any issuer for which conflict minerals are necessary to the functionality or production of a product manufactured or contracted by that issuer to be manufactured. The final rule does not define the term "manufacture" because we continue to believe, as discussed in the Proposing Release, that the term is generally understood. We note, however, that we do not consider an issuer that only services, maintains, or repairs a product containing conflict minerals to be "manufacturing" a product;[153] this interpretation is not a change from the Proposing

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[152] See letters from AT&T, CTIA, and RILA-CERC.

[153] See letter from JVC et al. II (commenting that "certain assembly and repair functions commonly performed by jewelry retailers" should not be defined as manufacturing).

Release, but a clarification in response to comments.[154]

We believe narrowing or expanding the definition of "manufacture" as suggested by some commentators would be inconsistent with the language and framework of Section 1502. For example, the NAICS definition, which a number of commentators suggested, appears to exclude any issuer that manufactures a product by assembling that product out of materials, substances, or components that are not in raw material form. Such a definition would exclude large categories of issuers that manufacture products through assembly, such as certain auto and electronics manufacturers, whom we believe are intended to be covered by the Conflict Minerals Statutory Provision. As another example, the manufacturing definition put forth by one commentator appears to include "importing, exporting, or sale of conflict minerals,"[155] which would expand the definition to include issuers that clearly do not manufacture products. Also, many of the other suggested definitions simply expound upon the generally understood meaning of the term, which we do not believe we need to define.

**ii. "Contract to Manufacture"**

Consistent with the proposal, the final rule applies to any issuer for which conflict minerals are necessary to the functionality or production of a product contracted by that issuer to be manufactured, including conflict minerals in a component of a product. In general, the question of whether an issuer contracts to manufacture a product will depend

[154] See, e.g., letter from ABA (commenting that the Commission "should, either in the final rule or in the corresponding adopting release, provide additional guidance as to activities that will not be considered to be the manufacturing of a product for the purposes of the rule").

[155] See letter from Earthworks.

on the degree of influence exercised by the issuer on the manufacturing of the product based on the individual facts and circumstances surrounding an issuer's business and industry. The final rule does not define when an issuer contracts to manufacture a product because, although we believe this concept is intuitive at a basic level, after considering comments and attempting to develop a precise definition, we concluded that, for "contract to manufacture" to cover issuers operating in the wide variety of the impacted industries and structured in various manners, any definition of that term would be so complicated as to be unworkable. We do, however, provide guidance below on some general principles that we believe are relevant in determining whether an issuer should be considered to be contracting to manufacture a product.

As a threshold matter, consistent with the proposal, we believe the statutory intent to include issuers that contract to manufacture their products is clear based on the statutory obligation for issuers to describe in their Conflict Minerals Reports products that are manufactured and contracted to be manufactured that do not meet the definition of "DRC conflict free."[156] We recognize that commentators asserted that the statute does not include an issuer that contracts to manufacture its products and that the sole intent behind including the phrase in the provision was to keep manufacturers from intentionally evading reporting requirements by contracting the manufacturing of their products to third parties. Nonetheless, Exchange Act Section 13(p)(1)(A)(ii) requires issuers that must file a Conflict Minerals Report to describe their "products manufactured or contracted to be manufactured that are not DRC conflict free" (emphasis added). In

[156] See Exchange Act Section 13(p)(1)(A)(ii).

our view, the inclusion of products that are "contracted to be manufactured" in this requirement indicates that Congress intended the Conflict Mineral Statutory Provision to apply to such products, and including issuers who contract to manufacture their products in the scope of the rule effectuates this intent. We believe our reading is more consistent with the statute than the alternative reading – that Congress required a description of products that were "contracted to be manufactured" and were not "DRC conflict free," but did not require issuers that contracted to manufacture products to determine whether a Conflict Minerals Report was required to be filed. This would be internally inconsistent. It would significantly undermine the purpose of the statutory provision to fail to apply it to issuers that contract to manufacture their products.

As another threshold matter, we believe the phrase "contract to manufacture" captures manufacturers that contract the manufacturing of components of their products. Generally, we believe that manufacturing issuers that contract the manufacturing of certain components of their products should, for purposes of the Conflict Minerals Statutory Provision, be viewed as responsible for the conflict minerals in those products to the same extent as if they manufactured the components themselves. We believe it is inconsistent with the Conflict Minerals Statutory Provision to allow these manufacturers to avoid the final rule's requirements by contracting out the manufacture of components in their products that contain conflict minerals. As two of the co-sponsors of the Conflict Minerals Statutory Provision noted, "[m]any companies use component parts from any one of several suppliers when assembling their products" to "help drive down the price for parts through competition," but "[i]t is of paramount importance that this business model choice not be used as a rationale to avoid reporting and transparency."[157]

In the proposal, we expressed our belief that an issuer that does not manufacture a product itself but that has "any" influence over the product's manufacturing should be considered to be contracting to manufacture that product. Also, we expressed our belief that an issuer that offers a generic product under its own brand name or a separate brand name should be considered to be contracting to manufacture that product so long as the issuer had contracted to have the product manufactured specifically for itself. We had believed that these issuers should have been considered to be contracting those products to be manufactured because the issuers would implicitly influence the manufacturing of the products. However, we are persuaded by commentators that this level of control set forth in the Proposing Release was "overbroad" and "confusing" and would impose on such an issuer "significant," "unrealistic," and "costly" burdens.[158]

Consistent with our approach in the Proposing Release, we believe that "contract to manufacture" is intended to include issuers that have some actual influence over the manufacturing of their products. However, we have modified our view as to the circumstances under which an issuer is considered to be contracting to manufacture a product. An issuer is considered to be contracting to manufacture a product depending on the degree of influence it exercises over the materials, parts, ingredients, or components to be included in any product that contains conflict minerals or their

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[157] See letter from Senator Richard J. Durbin and Representative Jim McDermott (Oct. 4, 2010) (Pre-Proposing Release website) ("Sen. Durbin / Rep. McDermott pre-proposing").

[158] See, e.g., letters from ABA, AT&T, Corporate Secretaries I, Davis Polk, and Verizon. See also letter from NRF I (stating that our proposed approach would be "draconian").

derivatives. The degree of influence necessary for an issuer to be considered to be contacting to manufacture a product is based on each issuer's individual facts and circumstances. However, based on comments we received, we believe an issuer should not be viewed for the purposes of the Conflict Minerals Statutory Provision as contracting to manufacture a product if its actions involve no more than:

(a) specifying or negotiating contractual terms with a manufacturer that do not directly relate to the manufacturing of the product, such as training or technical support, price, insurance, indemnity, intellectual property rights, dispute resolution, or other like terms or conditions concerning the product, unless the issuer specifies or negotiates taking these actions so as to exercise a degree of influence over the manufacturing of the product that is practically equivalent to contracting on terms that directly relate to the manufacturing of the product; or

(b) affixing its brand, marks, logo, or label to a generic product manufactured by a third party; or

(c) servicing, maintaining, or repairing a product manufactured by a third party.

For example, we agree with commentators that an issuer that is a service provider that specifies to a manufacturer that a cell phone it will purchase from that manufacturer to sell at retail must be able to function on a certain network does not in-and-of-itself exert sufficient influence to "contract to manufacture" the phone for purposes of the final rule. Under the proposed rules, however, such an issuer may have reached the "any" influence threshold. Conversely, we do not agree with commentators that an issuer must have "substantial" influence or control over the manufacturing of a product before the issuer is considered to be contracting to manufacture that product.[159] Such a standard would significantly limit the coverage of the Conflict Minerals Statutory Provision for issuers that contract to manufacture products, and we do not believe that such a narrow scope is consistent with the intent of the Conflict Minerals Statutory Provision. For example, if there are specifications made by an issuer to a manufacturer that it contracts with for the inclusion of a particular conflict mineral in the product, the issuer might not be viewed as exerting "substantial" influence on the overall manufacturing of the product. However, we would view such an issuer as covered under the final rule as contracting to manufacture the product. In addition, we disagree with commentators that suggested that the final rule should apply only to issuers that explicitly specify that conflict minerals be included in their products.[160] We believe this is too narrow an interpretation of the statutory provision and, read in this manner, the statute would be illogical. For example, as commentators argued, Congress inserted "contract to manufacture" in the disclosure of products to prevent manufacturers from skirting the disclosure requirements by contracting to manufacture certain products. However, if "contract to manufacture" is not included in the definition of "person described," an issuer may evade the statute by contracting its manufacturing to a third party. Therefore, an issuer would never be required to disclose its minerals because the issuer would not qualify for steps two and three.

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[159] See, e.g., letters from AT&T, Corporate Secretaries I, CTIA, JVC et al. II, NRF I, and Verizon.

[160] See, e.g., letters from NAM I and SEMI.

Moreover, in contrast to our approach in the Proposing Release, we do not consider an issuer to be contracting to manufacture a product for the purposes of our rule solely if it offers a generic product under its own brand name or a separate brand name without additional involvement by the issuer. We are persuaded by commentators that such an issuer would not necessarily exert a sufficient degree of influence on the manufacturer to be considered as contracting to manufacture the product for purposes of the Conflict Minerals Statutory Provision. As one commentator noted, it seems that such a relationship between an issuer and manufacturer is better characterized as one in which the manufacturer is using the issuer as a "sales channel" as opposed to one in which the issuer is "outsourcing manufacturing to" the manufacturer.[161] Such a relationship limits the issuer's influence on the product's manufacturing to the extent that it puts the issuer in a similar position to that of a pure retailer. One commentator noted that the purposes of the Conflict Minerals Statutory Provision are not served by classifying such an issuer as contracting to manufacture a product.[162] We agree. However, an issuer with generic products that include its brand name or a separate brand name and that has involvement in the product's manufacturing beyond only including such brand name would need to consider all of the facts and circumstances in determining whether its influence reaches such a degree so as to be considered contracting to manufacture that product.

### 3. Mining Issuers as "Manufacturing" Issuers

#### a. Proposed Rules

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[161] See letter from AT&T.

[162] See letter from Cleary Gottlieb.

Under the proposed rules, we would have considered an issuer that mines conflict minerals to be manufacturing those minerals and an issuer contracting for the mining of conflict minerals to be contracting for the manufacture of those minerals. In this regard, we proposed in an instruction to the rules that mining issuers be considered to be manufacturing conflict minerals when they extract those minerals.[163] We did, however, request comment on this point.

### b. Comments on the Proposed Rules

A number of commentators stated specifically that the final rule should consider any issuer that mines conflict minerals as "manufacturing" those conflict minerals as "products."[164] A few commentators noted that mining issuers should be included as manufacturers because they begin the conflict minerals supply chain and other reporting issuers must rely on them for information.[165] As such, without the final rule including mining issuers, other issuers would have a very difficult time complying with the rules, which would eliminate transparency from the supply chain and undermine the provision.[166]

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[163] See Industry Guide 7 [17 CFR 229.802(g)] (implying that companies may "produce" minerals from a mining reserve).

[164] See, e.g., letters from Bario-Neal Jewelry (Mar. 1, 2011) ("Bario-Neal"); Brilliant Earth, Inc. (Feb. 28, 2011) ("Brilliant Earth"); CRS I; Earthworks; Electronics TakeBack Coalition (Mar. 2, 2011) ("TakeBack"); Enough Project I; Enough Project (Nov. 2, 2011) ("Enough Project IV"); Global Tungsten I; Hacker Jewelers, Designers & Goldsmiths, Inc. (Mar. 1, 2011) ("Hacker Jewelers"); Hoover & Strong Inc. (Mar. 1, 2011) ("Hoover & Strong"); ICAR et al. I; NEI; Niotan I; NYCBar I; SIF I; State II; TIAA-CREF; TriQuint I; and US Steel.

[165] See letters from Global Witness I and TriQuint I (noting that mining companies do, in fact, engage in a transformative process such that they transform natural resources into ores, which should be considered "manufacturing").

[166] See letter from Enough Project I.

Other commentators indicated that the final rule should not treat mining issuers as manufacturers of the conflict minerals they extract.[167] Some of these commentators argued that the final rule should incorporate the NAICS definition of "manufacturing," which they noted does not include mining as a type of manufacturing activity.[168] Certain commentators noted that mining of conflict minerals, especially gold, shares no characteristics with the manufacturing of products.[169] Finally, some commentators asserted that Congress did not intend to include mining issuers as manufacturers based on previous versions of the Conflict Minerals Statutory Provision, legislative statements, and a plain reading of the statute.[170] As some of these commentators noted, the Conflict Minerals Statutory Provision was preceded by other legislative proposals that were drafted to include mining issuers, but the Conflict Minerals Statutory Provision was not drafted in such a manner.[171] One such commentator indicated that these previous bills "explicitly applied not only to companies using covered minerals in their manufacturing processes, but also to persons engaged in 'the commercial exploration, extraction, importation, exportation, or sale' of the covered minerals."[172] According to the commentator, the fact that Congress chose not to include extraction activities in the

[167] See, e.g., letters from ABA, AngloGold, Barrick Gold, Cleary Gottlieb, ITRI Ltd. (Jan. 27, 2011) ("ITRI I"), NAM III, NMA II, Vale S.A. (Mar. 3, 2011) ("Vale"), and WGC II.

[168] See letters from AngloGold and WGC II.

[169] See letters from AngloGold and Barrick Gold.

[170] See letters from AngloGold, NMA II, National Mining Association (Nov. 1, 2011) ("NMA III"), and Vale.

[171] See, e.g., letters from AngloGold and NMA II.

[172] Letter from NMA II (referring to S. 891 and S.A. 2707 (2009)).

Conflict Minerals Statutory Provision demonstrates that Congress's intent was not to have the Conflict Minerals Statutory Provision include mining as manufacturing.

c. **Final Rule**

After considering the comments, we are modifying the proposal. We do not consider an issuer that mines or contracts to mine conflict minerals to be manufacturing or contracting to manufacture those minerals unless the issuer also engages in manufacturing, whether directly or indirectly through contract, in addition to mining. In this regard, we do not believe that mining is "manufacturing" based on a plain reading of the provision. We agree with the commentators concerned that the statutory language does not explicitly include mining anywhere in the Conflict Minerals Statutory Provision and including mining would expand the statutory mandate. The Conflict Minerals Statutory Provision does not specifically refer to mining and, as one commentator noted, "[t]o extend the terms 'manufacture' of a 'product' to include the mining of conflict minerals contorts the plain meaning of those terms."[173]

As discussed by commentators, legislative history demonstrates that Congress did not intend to include issuers that solely mine conflict minerals in the Conflict Minerals provision because it removed references to such activities from prior versions of the provision. For example, one commentator in two comment letters noted that prior versions of the Conflict Minerals Statutory Provision explicitly applied to anyone either using covered minerals in their manufacturing processes or engaging in "the commercial

[173] See letter from AngloGold.

exploration, extraction, importation, exportation or sale of the covered minerals."[174] However, the final version of the Conflict Minerals Statutory Provision omits any reference to extraction-related activities and refers solely to manufacturing.[175] As this commentator stated, Congress's omission of mining activities evidences its intent "to address the manufacturing of goods which use or contain, as opposed to the extracting and processing of, the covered minerals."[176] Therefore, based on both the plain reading of the provision and the legislative history of the provision, we are persuaded that it would be inconsistent with the language in the Conflict Minerals Statutory Provision to include mining issuers as manufacturing issuers under the final rule unless the mining issuer engages in manufacturing, either directly or through contract, in addition to mining.

**4. When Conflict Minerals Are "Necessary" to a Product**

The Conflict Minerals Statutory Provision requires us to promulgate regulations requiring that any "person described" disclose annually whether conflict minerals that are "necessary" originated in the Covered Countries and, if so, submit to us a Conflict Minerals Report.[177] The provision further states that a "person is described" if "conflict minerals are necessary to the functionality or production of a product manufactured by

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[174] See letters from NMA II and NMA III. These letters discuss two legislative proposals introduced in the Senate in 2009 that were similar to the Conflict Minerals Statutory Provision. See Congo Conflict Minerals Act of 2009, S. 891, 111th Cong. (2009) and S.A. 2707, 111th Cong. (2009). Both of these earlier conflict minerals proposals explicitly applied to companies using conflict minerals in their manufacturing processes and also to persons engaged in "the commercial exploration, extraction, importation, exportation, or sale" of conflict minerals.

[175] See letters from NMA II.

[176] Id.

[177] Exchange Act Section 13(p)(1)(A).

such person."[178] The provision, however, provides no additional explanation or guidance as to the meaning of "necessary to the functionality or production of a product." Likewise, we did not propose to define when a conflict mineral is necessary to the functionality or production of a product. We did, however, request comment on whether and how our rules should define this phrase and we provided some guidance as to the meaning of "necessary to the production of a product."

### a. Proposed Rules

Although we did not propose to define "necessary to the functionality or production" in the rules, we noted in the Proposing Release that, if a mineral is necessary, the product was included within the scope of the rules without regard to the amount of the mineral involved. Further, we indicated in the Proposing Release that a conflict mineral would be considered necessary to the production of a product if the conflict mineral was intentionally included in a product's production process and was necessary to that process, even if that conflict mineral was not ultimately included anywhere in the product. On the other hand, as proposed, a conflict mineral necessary to the functionality or production of a physical tool or machine used to produce a product would not be considered necessary to the production of that product, even if that tool or machine was necessary to producing the product. For example, if an automobile containing no conflict minerals was produced using a wrench that contains or was itself produced using conflict minerals necessary to the functionality or production of that wrench, the proposed rules would not consider the conflict minerals in that wrench necessary to the production of the

[178] Exchange Act Section 13(p)(2)(B).

automobile.

That the conflict minerals must be "necessary to the functionality or production" of an issuer's products is the only limiting factor in the Conflict Minerals Statutory Provision.[179] The provision has no materiality thresholds for disclosure based on the amount of conflict minerals an issuer uses in its manufacturing processes. Therefore, we did not propose to include a materiality threshold for the disclosure or reporting requirements in the proposed rules. We did, however, request comment in the Proposing Release as to whether there should be a de minimis threshold in our rules based on the amount of conflict minerals used by an issuer in a particular product or in its overall enterprise and, if so, whether such a threshold would be consistent with the Conflict Minerals Statutory Provision.

**b. Comments on the Proposed Rules**

Many commentators suggested that the final rule explicitly define the phrase "necessary to the functionality or production of a product,"[180] while other commentators indicated that the final rule should not define the phrase.[181] Several commentators suggested possible definitions.[182] One commentator noted that manufacturers make certain deliberate choices about products, such as how they look, function, perform, cost,

[179] Exchange Act Section 13(p)(2)(B).

[180] See, e.g., letters from CRS I, Davis Polk, Earthworks, Enough Project I, FRS, Howland, ICAR et al. I, MSG I, NRF I, PCP, Give Peace A Deadline (Jan. 21, 2011) ("Peace"), SEMI, SIF I, TIC, Tiffany, TriQuint I, and US Steel.

[181] See, e.g., letters from Cleary Gottlieb, Global Witness I, ITIC I, State II, and WGC II.

[182] See, e.g., letters from AAEI, AAFA, Bario-Neal, Brilliant Earth, CRS I, Davis Polk, Earthworks, Enough Project I, Hacker Jewelers, Hoover & Strong, Howland, MSG I, NAM I, Niotan I, NMA II, NRF I, PCP, Peace, SEMI, Sen. Durbin / Rep. McDermott, SIF I, TIAA-CREF, TIC, TriQuint I, and US Steel.

or are supplied, so when there has been a choice to incorporate conflict minerals into a product, the final rule should consider the conflict minerals "necessary" to the product because the designer has deemed them to be so.[183] Another commentator was concerned that the proposed rules did not provide any guidance as to either the phrase "necessary to the functionality or production" or the term "product."[184] As such, this commentator noted that the proposed rules could apply to financial products that are backed by gold or other mineral commodities, such as futures contracts for gold bullion, shares in mutual funds that invest in gold mining stocks, or gold bullion storage agreements with vault services providers.

**i. "Necessary to the Functionality"**

A number of different commentators indicated that a conflict mineral should be considered "necessary to the functionality" of a product if that conflict mineral is intentionally added to the product.[185] Of these commentators, however, many were open to other potential requirements. For example, many commentators suggested further requirements in addition to, or instead of, being intentionally added before a conflict mineral should be considered "necessary to the functionality" of a product. Many of these commentators indicated that a conflict mineral must be intentionally added and/or necessary either for the product's use, purpose, or marketability, financial success, or

183 See letter from Matheson II.

184 See letter from Tiffany.

185 See, e.g., letters from AAEI, Bario-Neal, Brilliant Earth, Hacker Jewelers, Hoover & Strong, Howland, ITIC I, NRF I, NYCBar II, SEMI, Sen. Durbin / Rep. McDermott, TIAA-CREF, and WGC II.

some combination thereof.[186] A few commentators asserted that a conflict mineral must be intentionally added and essential to the product's function.[187] One commentator stated that a conflict mineral must be intentionally added and have a concentration in the product that exceeds 1,000 ppm per homogeneous material.[188]

Only a few commentators proposed guidance as to when a conflict mineral would be considered "intentionally added" to a product, and they differed on when a conflict mineral should be considered "intentionally added." One commentator stated that a conflict mineral should not be considered intentionally added if it was unilaterally included in a sub-component acquired by the issuer from a sub-contractor.[189] Two of the co-sponsors of the Conflict Minerals Statutory Provision, however, took the opposite position and stated that a conflict mineral should be considered intentionally added if it is intentionally added in sub-components that an issuer contracts to manufacture through third parties or subsidiaries.[190] Several commentators agreed that a conflict mineral occurring naturally in a product should not be considered intentionally added to that product.[191]

Instead of being intentionally added to a product, some commentators provided other bases for concluding that a conflict mineral is "necessary to the functionality" of a

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[186] See, e.g., letters from AAEI, Bario-Neal, Brilliant Earth, Earthworks, Enough Project I, Hacker Jewelers, Hoover & Strong, MSG I, Peace, and SIF I, and TIAA-CREF.

[187] See, e.g., letters from Howland, NAM I, and NRF I.

[188] See letter from TriQuint I.

[189] See letter from SEMI.

[190] See letter from Sen. Durbin / Rep. McDermott.

[191] See letters from ITIC I, PCP, and Sen. Durbin / Rep. McDermott.

product. Some commentators indicated that a conflict mineral should be considered "necessary to the functionality" of a product if that conflict mineral is necessary for the product's basic function.[192] Other commentators stated that the basic function test would be unworkable because there is no meaningful distinction between a product's basic and auxiliary functions.[193] Some commentators stated that a conflict mineral should be considered "necessary to the functionality" of a product if that conflict mineral is required either for the financial success or marketability of the product.[194] One commentator noted that "necessary to the functionality" should be defined broadly enough that it encompasses uses necessary to the product's economic utility,[195] while others disagreed due to the subjective nature of what provides economic utility to a product.[196] In this regard, one commentator asserted that a conflict mineral should be considered "necessary to the functionality" of a product if the issuer "uses" conflict minerals in any manner in a product, regardless of how those conflict minerals relate to the product's function, because any other test would be too subjective.[197]

### ii. "Necessary to the Production"

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[192] See letters from AAFA, NYCBar I, and WGC II. See also letter from NYCBar II (stating that a "component in a product necessary to its functionality if it is needed for either its basic function or another commercially valuable function of that product," and stating that it does not "believe that 'basic function' in this regard needs to be defined since it will differ for each product").

[193] See letters from NEI, SEMI, and TIC.

[194] See, e.g., letters from Enough Project I, MSG I, Peace, and TIAA-CREF.

[195] See letter from CRS I (suggesting "that 'necessary to the functionality or production of a product' be defined broadly enough that it encompasses uses necessary to the economic utility and/or marketability of that product").

[196] See, e.g., letters from NRF I and SEMI.

[197] See letter from Kemet.

Many commentators agreed that a conflict mineral should be considered "necessary to the production" of a product if it is intentionally added to the production process, and should not be considered "necessary to the production" of a product if it is unintentionally added to a product or naturally occurring in a product.[198] Some commentators agreed with the proposal to consider such conflict minerals "necessary to the production" of a product even if the minerals are washed away or consumed in the production process and do not end up in the product, such as with a catalyst.[199] As one of these commentators suggested as an example, a "catalyst used to make a substance or a die containing [conflict mineral] metals used to make a part" should be considered "necessary to the production" of the product using that part because the "part is made with direct involvements of the [conflict mineral] metal and then the part/material is used in the product;" even if the conflict mineral does not end up in the product.[200] Other commentators, however, did not believe that conflict minerals used in the production of a product should be considered necessary to that production process if they are washed away or consumed in the process.[201] As one of these commentators pointed out, it would be "impossible for a retailer to know whether his supplier's supplier's supplier used and washed away a conflict mineral" because "there is no meaningful measurement capability or audit trail, especially as a product moves through dozens of suppliers in a supply

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198 See, e.g., letters from ITIC I, Global Witness I, Japanese Trade Associations, NYCBar I, PCP, SEMI, Sen. Durbin / Rep. McDermott, and TIC.

199 See, e.g., letters from Howland, MSG I, Niotan I, PCP, SEMI, and TriQuint I.

200 See letter from Howland.

201 See, e.g., letters from Industry Group Coalition I, IPC II, NAM I, Griffin Teggeman (Dec. 16, 2010) ("Teggeman"), and WGC II.

chain."[202]

A number of commentators addressed whether a conflict mineral necessary to the production of the tools, machines, or similar equipment that are used to produce an issuer's product should be considered "necessary to the production" of the issuer's product.[203] The large majority of these commentators, including those from industry associations,[204] a multi-stakeholder group representing both human rights organizations and industry,[205] and institutional investors,[206] agreed with the proposed rules that such tools, machines, and other production equipment should not be considered necessary to the production of the issuer's products.[207] A small number of commentators disagreed and stated that such tools, machines, or similar equipment should be considered necessary to the production of an issuer's product.[208] One of these commentators specified that tools, machines, or similar equipment purchased going forward should be considered necessary to the production of the issuer's product, although an issuer's existing

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[202] See letter from Teggeman.

[203] See, e.g., letters from AAFA, Industry Group Coalition I, IPC I, ITIC I, Japanese Trade Associations, NAM I, NEI, Niotan I, Refractory Metals Association (Feb. 28, 2011) ("RMA"), SEMI, SIF I, TIAA-CREF, TIC, and TriQuint I.

[204] See, e.g., letters from AAFA, Industry Group Coalition I, IPC I, ITIC I, Japanese Trade Associations, NAM I, RMA, SEMI, and TIC.

[205] See letter from MSG I (stating that "when conflict minerals are present in tooling or other production machinery, they should not be considered to be necessary to production of the product"). The letter from MSG was signed by a number of human rights groups, including Enough Project, Free the Slaves, and Friends of the Congo, among others.

[206] See, e.g., letters from NEI, SIF I, and TIAA-CREF.

[207] See, e.g., letters from AAFA, Industry Group Coalition I, IPC I, ITIC I, Japanese Trade Associations, NAM I, NEI, RMA, SEMI, SIF I, TIAA-CREF, and TIC.

[208] See letters from Niotan I and TriQuint I.

production equipment should not be deemed necessary to production.[209] Another commentator stated that production equipment should not be considered necessary to the production of an issuer's products unless the issuer intentionally and explicitly required the producer of the tools, machines, or other production equipment to include conflict minerals.[210]

In this regard, one commentator stated that the final rule should not consider any indirect equipment, such as computers or power lines, as necessary to production.[211] Another commentator indicated that conflict minerals used in products that are "not intended to be sold into commerce," such as those utilized solely for research and development purposes, components provided at cost on a business-to-business basis, or products or components used only for engineering or testing purposes, should not be considered necessary to the production of the product that is ultimately placed in the stream of commerce.[212]

iii. De Minimis Threshold

We received mixed comments regarding whether the final rule should have a de minimis threshold exception, with some commentators opposed to a de minimis exception,[213] and other commentators supporting it.[214] Some commentators provided a

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[209] See letter from TriQuint I.

[210] See letter from SEMI.

[211] See letter from Howland.

[212] See letter from ITIC I. See also letter from TechAmerica (Nov. 1, 2011) ("Industry Group Coalition II") (suggesting that the final rule should exclude "research and development equipment made available on a business-to-business basis from the scope of the rule").

[213] See, e.g., letters from Calvert, Earthworks, Episcopal Conference of Catholic Bishops of the DRC (Nov. 8, 2011) ("CENCO II"), Global Witness I, Howland, Matheson II, NEI, NYCBar I, NYCBar II, Rep.

legal basis for including a de minimis exception despite the lack of a de minimis exception in the Conflict Minerals Statutory Provision.[215] Generally, these commentators asserted that, as long as legislation does not forbid establishing a de minimis threshold, an agency's regulations may allow for one. Also, one commentator noted that we have "inherent authority to employ de minimis exceptions to avoid unreasonable and absurd results in crafting [the] final rule," which is "inherent and clearly established by precedent."[216]

Some commentators provided recommendations on possible de minimis thresholds. Two commentators suggested that there should be a de minimis exception if the cost of the conflict minerals in an issuer's products make up less than 1% of the issuer's consolidated total production costs.[217] Other commentators recommended a de minimis exception for trace, nominal, or insignificant amounts of conflict minerals in an issuer's products.[218] One commentator suggested a de minimis exception when the end product derived from conflict minerals reflects less than a certain percentage of the value of the product, such as if the value was 5% or less of the total manufacturing costs.[219] Another commentator recommended a de minimis exception relating to the inability of an

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Berman et al., SIF I, State II, and Trott.

214 See, e.g., letters from AAFA, AdvaMed I, AngloGold, Chamber I, Davis Polk, IPC I, IPC II, IPMI I, NAM I, NRF I, PCP, Rep. Bachus et al., Roundtable, SEMI, Teggeman, TIC, and WGC II.

215 See letters from Materion, NAM I, and NRF I.

216 See letter from Materion.

217 See letters from AngloGold and WGC II.

218 See letters from Davis Polk, NRF I, and Roundtable.

219 See letter from TIC.

issuer to determine the origin of its minerals, such as allowing that issuer's product to be considered "DRC conflict free" where the issuer is unable to determine the origin of only 5% of the product's minerals.[220] One commentator noted that the final rule should permit a de minimis exception, but indicated that the value used for the de minimis exception should be based on how the phrase "necessary to the functionality or production" of a product is to be defined in the final rule.[221] Another commentator recommended that the final rule permit a de minimis exception for products containing less that 0.1% by weight of a conflict mineral.[222] One commentator provided three possible de minimis scenarios in which an issuer would be excepted from reporting, specifically: if an issuer's conflict minerals comprised less than 0.1% of a component or product, if an issuer's global usage of conflict minerals comprised less than 0.01% of its materials, or if an issuer comprised the bottom 20% of its industry's conflict minerals use.[223]

c. **Final Rule**

After considering the comments, we are adopting a final rule that, like the proposed rules, does not define when a conflict mineral is "necessary to the functionality" of a product or when it is "necessary to the production" of a product.[224] However, as we

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[220] See letter from IPMI I.

[221] See letter from SEMI (stating that, if the phrase was limited to materials explicitly or intentionally added to a product or caused to be added to a product, the de minimis threshold should be one gram per year of necessary minerals, but if the final rule included a "more conservative" meaning of the phrase, a higher de minimis should be used, such as 0.1% of the weight of any particular component acquired as a whole by the issuer).

[222] See letter from IPC I.

[223] See letter from NAM I.

[224] As a threshold matter, we believe that the Conflict Minerals Statutory Provision requires separate consideration as to whether a conflict mineral is "necessary to the production" of a product from whether a

did in the Proposing Release, we are providing guidance regarding the interpretation of these phrases. The guidance is modified to a degree from the guidance in the Proposing Release based on comments we received. Whether a conflict mineral is deemed "necessary to the functionality" of a product or "necessary to the production" of product depends on the issuer's particular facts and circumstances, but there are certain factors we believe issuers should consider in making their determinations.

As described below, in determining whether its conflict minerals are "necessary to the functionality" of a product, an issuer should consider: (a) whether a conflict mineral is contained in and intentionally added to the product or any component of the product and is not a naturally-occurring by-product; (b) whether a conflict mineral is necessary to the product's generally expected function, use, or purpose; or (c) if a conflict mineral is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration. Based on the applicable facts and circumstances, any of these factors, either individually or in the aggregate, may be determinative as to whether conflict minerals are "necessary to the functionality" of a given product. In determining whether its conflict minerals are "necessary to the production" of a product, an issuer should consider whether a conflict mineral is contained in the product and intentionally added in the product's production process, including the production process of any component of the product; and whether the conflict mineral is necessary to produce the product. We describe changes to our

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conflict mineral is "necessary to the functionality" of the product, because the Conflict Minerals Statutory Provision includes both phrases. See infra Part II.B.4.c.iii. See also Exchange Act Sections 13(p)(1)(A) and 13(p)(2).

guidance regarding "necessary to the functionality" and "necessary to the production" below.

i. Contained in the Product

After considering the comments and reviewing the Conflict Minerals Statutory Provision, as described below, we are persuaded that only a conflict mineral that is contained in the product should be considered "necessary to the functionality or production" of that product. We believe this approach is appropriate in light of the Conflict Minerals Statutory Provision's statutory construction. As discussed above, the Conflict Minerals Statutory Provision requires issuers with conflict minerals "necessary to the functionality or production" of a product manufactured or contracted by the issuer to be manufactured that originated in the Covered Countries to provide a Conflict Minerals Report.[225] The provision includes two distinct subsections, Exchange Act Section 13(p)(1)(A)(i) and Exchange Act Section 13(p)(1)(A)(ii), regarding the information required in that Conflict Minerals Report. Generally, Exchange Act Section 13(p)(1)(A)(i) deals with an issuer's description of its due diligence measures on the source and chain of custody of its conflict minerals, including the independent private sector audit, and Exchange Act Section 13(p)(1)(A)(ii) requires the issuer's description of its products that have not been found to be "DRC conflict free." The Conflict Minerals Statutory Provision defines "DRC conflict free" to mean "products that do not contain minerals that directly or indirectly finance or benefit armed groups" in the Covered

[225] See Exchange Act Section 13(p)(1)(A).

Countries.[226] The use of the term "contain" indicates that the disclosures required under Exchange Act Section 13(p)(1)(A)(ii) are limited to issuers with conflict minerals actually contained in their products.[227] We believe it is appropriate to include this limitation in interpreting when a conflict mineral is necessary to the functionality or production of a product.

We note that Exchange Act Section 13(p)(1)(A)(i) does not include a similar limitation that the product must "contain" the necessary conflict minerals. As a result, it is possible to interpret the Conflict Minerals Statutory Provision such that the term "contain" in Exchange Act Section 13(p)(1)(A)(ii) does not mean that a conflict mineral must be included in the product for it to be "necessary to the functionality or production" of the product. However, we do not believe that such an interpretation would be the proper construction. Following that approach, the provision could be interpreted to require issuers with conflict minerals that are "necessary to the functionality or production" of a product but are not included in that product to submit an audited Conflict Minerals Report describing their due diligence, as required under Exchange Act Section 13(p)(1)(A)(i), but not describing any products produced using those minerals that directly or indirectly financed or benefited armed groups in the Covered Countries as having not been found to be "DRC conflict free" because the conflict minerals are not "contained" in the product.

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[226] Id. (emphasis added). See also Section 1502(e)(4) of the Act (defining the phrase in the same manner as Exchange Act Section 13(p)(1)(A)(ii), except that Section 1502(e)(4) of the Act refers to "conflict minerals" instead of just "minerals").

[227] We note that the Second Edition of the Random House Webster's Dictionary defines "contain" to include the "to hold within a volume or area." RANDOM HOUSE WEBSTER'S DICTIONARY, 142 (2d ed. 1996).

We do not believe, however, that such an interpretation is the better construction. It would mean that the Conflict Minerals Statutory Provision envisions a situation in which an issuer with a conflict mineral that is "necessary to the functionality or production" of its product originated in the Covered Countries and benefited armed groups in those countries would be required to submit a Conflict Minerals Report describing its due diligence on the source and chain of custody of that mineral but would not have to describe its products as having not been found to be "DRC conflict free." We believe the better interpretation that gives meaning to the term "contain" is that only conflict minerals contained in the product would be considered "necessary" to that product, so only those minerals trigger the requirement to conduct a reasonable country of origin inquiry.

Additionally, we do not believe the final rule should include conflict minerals "necessary to the functionality or production" of a product that are not contained in the product because we appreciate commentators' concerns that the application of the provision to minerals that do not end up in the product is especially challenging. As noted above, commentators were mixed in their views regarding how the rule should treat catalysts and other conflict minerals necessary to the production of a product that do not appear in the product. However, we note that there are products where a catalyst is used and is not completely washed away.[228] In those situations, the product contains a necessary conflict mineral that is necessary to its production and is subject to the final

[228] See letters from Industry Group Coalition I and NAM I (referring specifically to situations in which catalysts are used to chemically react with and produce products, and trace levels of the catalyst are found in the reacted manufactured product, but the catalysts do not contribute to the performance of the product).

rule.

### ii. Intentionally Added

Although commentators did not agree on an exact definition, most commentators from across the spectrum agreed that a conflict mineral should be considered "necessary to the functionality or production" of a product for the purposes of the Conflict Minerals Statutory Provision if, at a minimum, it was intentionally added to the product or production process.[229] While we are not defining the phrase, we agree that being intentionally added, rather than being a naturally-occurring by-product, is a significant factor in determining whether a conflict mineral is "necessary to the functionality or production" of a product. This is true regardless of who intentionally added the conflict mineral to the product so long as it is contained in the product.

In this regard, we note that one commentator asserted that a conflict mineral should not be considered "intentionally added" by an issuer "if it is present in a sub-component acquired by the issuer based on a unilateral decision of the supplier or a sub-contractor, or a party further upstream in the supply chain."[230] We disagree. As two of the co-sponsors of the provision asserted, determining whether a conflict mineral is considered "necessary" to a product should not depend on whether the conflict mineral is added directly to the product by the issuer or whether it is added to a component of the product that the issuer receives from a third party. Instead, the issuer should "report on

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[229] See, e.g., letters from AAEI, Bario-Neal, Brilliant Earth, Earthworks, Enough Project I, Global Witness I, Hacker Jewelers, Hoover & Strong, Howland, ITIC I, Japanese Trade Associations, MSG I, Niotan I, NRF I, Peace, PCP, SEMI, Sen. Durbin / Rep. McDermott, SIF I, TIAA-CREF, TriQuint I, and WGC II.

[230] See letter from SEMI.

the totality of the product and work with suppliers to comply with the requirements."[231] Therefore, in determining whether a conflict mineral is "necessary" to a product, an issuer must consider any conflict mineral contained in its product, even if that conflict mineral is only in the product because it was included as part of a component of the product that was manufactured originally by a third party.

### iii. "Necessary to the Functionality"

In addition to being contained in the product and intentionally added, another factor in determining whether its conflict minerals are "necessary to the functionality" of a product is whether the conflict mineral is necessary to the product's generally expected function, use, or purpose. Some commentators suggested that we limit an issuer's consideration of whether its conflict minerals are "necessary to the functionality" of a product to the "basic function" or "economic utility" tests. However, we believe limiting a determination to those tests would not provide greater certainty or clarity to issuers required to make such determinations. As one commentator noted, "the distinction between a 'basic function' and an ancillary function is murky and undefinable."[232] Similarly, as another commentator noted, "[e]conomic utility is very subjective and it can be the unforeseen consequence of a derivative buried deep within a sub-component."[233] Therefore, we believe these tests are so subjective as to be mostly unworkable. We believe it is more appropriate instead to focus on a product's generally expected function,

[231] See letter from Sen. Durbin / Rep. McDermott (indicating that a car manufacturer must report on any conflict minerals in the car's radio, even if there are no conflict mineral elsewhere in the car).

[232] See letter from TIC.

[233] See letter from SEMI.

use, or purpose, recognizing that there are situations in which a product has multiple generally expected functions, uses, and purposes. In such situations, a conflict mineral need only be necessary for one such function, use, or purpose to be necessary to the product as a whole. For example, a smart phone has multiple generally expected functions, uses, and purposes, such as making and receiving phone calls, accessing the internet, and listening to stored music. If a conflict mineral is necessary to the function, use, or purpose of any one of these, it is necessary to the functionality of the phone.

Another factor in determining whether its conflict minerals are "necessary to the functionality" of a product is whether the conflict mineral is incorporated for purposes of ornamentation, decoration, or embellishment. If a primary purpose of the product is mainly ornamentation or decoration, it is more likely that a conflict mineral added for purposes of ornamentation, decoration or embellishment is "necessary to the functionality" of the product. For example, the gold in a gold pendant hanging on a necklace is necessary to the functionality of the pendant because it is incorporated for purposes of ornamentation, decoration, or embellishment, and a primary purpose of the pendant is ornamentation or decoration. Conversely, if a conflict mineral is incorporated into a product for purposes of ornamentation, decoration, or embellishment, and the primary purpose of the product is not ornamentation or decoration, it is less likely to be "necessary to the functionality" of the product. As one commentator noted, "if, for example, gold is used in an article as an ancillary feature [of a product] strictly for purposes of ornamentation, then it is unrelated to the functionality of the product and would be exempt from the reporting requirements of the statute."[234] We would agree that these facts would tend to indicate that the conflict mineral is not necessary to the functionality of the product, provided that the primary purpose of the product is not for ornamentation or decoration. Even so, this would only be one factor among all the facts and circumstances in the issuer's overall determination as to whether the conflict mineral is necessary to the functionality of the product.

**iv. "Necessary to the Production"**

As with determining whether a conflict mineral is "necessary to the functionality" of a product, determining whether a conflict mineral is "necessary to the production" of a product involves consideration of an issuer's particular facts and circumstances. As noted above, the conflict mineral must be contained in the product to trigger the determination of whether the conflict mineral is "necessary to the production" of the product. Consistent with this approach, we do not consider a conflict mineral used as a catalyst or in another manner in the production process of a product to be "necessary to the production" of the product if that conflict mineral is not contained in the product, even though, based on the facts and circumstances, the conflict mineral would have otherwise been considered "necessary to the production" of the product had the conflict mineral been included in the product. As one commentator noted for gold, and we believe this is applicable for the other conflict minerals as well, the "use of gold as a catalyst in producing products which do not in themselves contain gold will broaden the

[234] See letter from NRF I.

reach of the regulations beyond what Section 1502 envisaged."[235] We do, however, consider a conflict mineral used as a catalyst or in another manner in the production process of a product to be "necessary to the production" of the product 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.[236]

As we indicated in the Proposing Release, we continue to believe that a conflict mineral in a physical tool or machine used to produce a product does not fall under the "necessary to the production" language in the Conflict Minerals Statutory Provision.[237] One commentator asserted that the language in the Conflict Minerals Statutory Provision is intended to cover conflict minerals in tools or machines that are necessary for the production of a product and, "[i]n the absence of such specificity, the rule will fail to ensure reporting on the use of such tools or catalysts, thus leaving out a significant market for the minerals and undermining the purpose of the law."[238] We do not believe that a conflict mineral in a tool or machine is captured by the Conflict Minerals Statutory Provision because, although the conflict mineral may be included in the tool or machine,

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[235] See WGC II.

[236] We note that this interpretation continues to bring catalysts within the scope of the reporting requirements when they are necessary to the production of the product. We understand that not all catalysts are washed away in the production process, and the remaining minerals may not be "necessary to the functionality" of the product. See letters from Industry Group Coalition I and NAM I (referring specifically to situations in which catalysts are used to chemically react with and produce products, and trace levels of the catalyst are found in the reacted manufactured product, but the catalysts do not contribute to the performance of the product).

[237] However, the issuer that manufactures or contracts to manufacture the tool or machine would likely come within the "necessary to the production" or "necessary to functionality" language.

[238] See letter from Niotan I.

it is the tool or machine and not the conflict mineral that is necessary to the production.[239] Additionally, the tool or machine is unlikely to be contained in the final product.

Like tools and machines, indirect equipment used to produce a product, such as computers and power lines, does not bring the product that is produced with the equipment into the "necessary to the production" language.[240] We do not consider a conflict mineral necessary to the functionality or production of such indirect equipment to be necessary to the production of the product because that conflict mineral is only tangentially necessary for production of the product. Similarly, we do not require issuers to report on the conflict minerals in materials, prototypes, and other demonstration devices containing or produced using conflict minerals that are necessary to the functionality or production of those items because we do not consider those items to be products. Once an issuer enters those items in the stream of commerce by offering them to third parties for consideration, the issuer will be required to report on any conflict minerals necessary to the functionality or production of those products.

**v. De Minimis Threshold**

Finally, after considering the comments, the final rule does not include a de minimis exception. The statute itself does not contain a de minimis exception, and for

[239] As described above, we consider a conflict mineral that is "necessary to the functionality" of a component product also to be "necessary to the functionality" of any subsequent product that incorporates the component product. We recognize that this could be seen as a two-step analysis, and thus it could be asserted that the conflict mineral in the component product is not necessary to the functionality of the subsequent product. We disagree with this view, however, because a component added to a subsequent product becomes part of that subsequent product, which removes any segregation from the component and the subsequent product and makes the conflict mineral directly necessary to the functionality of the subsequent product.

[240] However, the issuer that manufactures or contracts to manufacture the indirect equipment would likely come within the definition of either "necessary to the functionality" or "necessary to the production" for the indirect equipment.

several reasons we believe it would be contrary to the Conflict Minerals Statutory Provision and Congressional purpose to include one in the final rule. First, we note that the Conflict Minerals Statutory Provision does include an express limiting factor – namely that a conflict mineral must be "necessary to the functionality or production" of an issuer's product to trigger any disclosure regarding those conflict minerals.[241] As discussed above, this standard focuses on whether the conflict mineral is "necessary" to a product's functionality or production; it does not focus on the amount of a conflict mineral contained in the product. We believe that Congress understood, in selecting the standard it did, that a conflict mineral used in even a very small amount could be "necessary" to the product's functionality or production. If it had intended that the provision be limited further, so as not to apply to a de minimis use of conflict minerals, we think Congress would have done so explicitly. In this regard, we note that in Section 1504 of the Act, which adds Exchange Act Section 13(q) as part of the same title (Title XV) of the Act ("Miscellaneous Provisions"), Congress did explicitly include a de minimis threshold for the requirement to disclose certain payments by resource extraction issuers.[242]

In addition, we believe that the purpose of the Conflict Minerals Statutory Provision would not be properly implemented if we included a de minimis exception in our final rule. As the State Department noted in its comment letter, "[i]n light of the

[241] See Exchange Act Sections 13(p)(1)(A) and 13(p)(2)(B).

[242] See Section 1504 of the Act and Exchange Act Section 13(q). Exchange Act Section 13(q)(1)(C) states that "the term 'payment,' means a payment that is made to further the commercial development of oil, natural gas, or minerals; and not de minimis."

nature" of the conflict minerals, they are often used in products "in very limited quantities," so including a de minimis threshold "could have a significant impact on" the final rule.[243] Consistent with the views of the State Department, we believe Congress intended the disclosure provisions to apply to the use of even small amounts of conflict minerals originating in the Covered Countries.

We are cognizant of the fact that, by not including a de minimis exception, even minute or trace amounts of a conflict mineral could trigger disclosure obligations.[244] However, a de minimis amount of conflict minerals triggers disclosure obligations only if those conflict minerals are necessary for the functionality or production of a product, and we understand that there are instances in which only a minute amount of conflict minerals is necessary for the functionality or production of a product. Therefore, consistent with the proposal, our final rule applies to issuers for which any conflict minerals are necessary to the functionality or production of a product manufactured or contracted by the issuer to be manufactured regardless of the amount of the conflict mineral.

We recognize that not including a de minimis exception in the final rule will be more costly for issuers than if we included one. As described above, however, we are of the view that Congress intended not to provide for a de minimis exception, and including one in the final rule would therefore thwart, rather than advance, the provision's purpose. Further, we believe focusing on whether the mineral was intentionally added addresses

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243 See State II ("In light of the nature in which the covered minerals are often used in products, i.e. often in very limited quantities, such a change could have a significant impact on the proposed regulations. A de minimis threshold should not be considered under current circumstances.").

244 See letters from Chamber I and NRF I.

some of the concerns regarding de minimis amounts of minerals. For example, according to one commentator, a number of metal alloys, including the high volume materials of cold rolled steel, hot rolled steel, and stainless steel, contain tin only as a contaminant, such that it is not part of the specification of these alloys.[245] Therefore, the tin in these alloys is not intentionally added, and we do not consider the tin "necessary to the functionality or production" of any product containing those alloys.

## C. Location, Status, and Timing of Conflict Minerals Information

Once it is determined that conflict minerals are necessary to the functionality or production of a product manufactured or contracted by the issuer to be manufactured, the issuer will have to submit conflict minerals information in accordance with the final rule.

### 1. Location of Conflict Minerals Information

#### a. Proposed Rules

Our proposed rules would have required issuers to provide their disclosure about conflict minerals in their annual reports on Form 10-K for a domestic issuer,[246] Form 20-F for a foreign private issuer,[247] and Form 40-F for a Canadian issuer that files under the Multijurisdictional Disclosure System,[248] with their Conflict Minerals Reports as an exhibit to their annual report.[249] Section 1502 requires issuers to disclose information

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[245] See letter from Claigan Environmental Inc. (Dec. 16, 2011) ("Claigan III").

[246] 17 CFR 249.310.

[247] 17 CFR 249.220f.

[248] 17 CFR 249.240f.

[249] In the Proposing Release, we indicated that, by requiring an issuer to provide its Conflict Minerals Report as an exhibit to its annual report, the proposed rules would enable anyone accessing the Commission's Electronic Data Gathering, Analysis, and Retrieval system (the "EDGAR" system) to determine quickly whether an issuer furnished a Conflict Minerals Report with its annual report.

about their conflict minerals annually, but does not otherwise specify where this disclosure must be located, either in terms of which form or in terms of where within a particular form. Our proposed rules would have required this disclosure in the existing Form 10-K, Form 20-F, or Form 40-F annual report because issuers were already required to file these reports so we believed this approach would be less burdensome than requiring a separate annual report. To facilitate locating the conflict minerals disclosure within the annual report without over-burdening investors with extensive information about conflict minerals in the body of the report, our proposed rules would have required issuers to include brief conflict minerals disclosure under a separate heading entitled "Conflict Minerals Disclosure" and more extensive information in a separate exhibit to the annual report.

We proposed to require that an issuer disclose in its annual report under a separate heading, entitled "Conflict Minerals Disclosure," its determination as to whether any of its conflict minerals originated in the Covered Countries, based on its reasonable country of origin inquiry, and, for its conflict minerals that did not originate in the Covered Countries, a brief description of the reasonable country of origin inquiry it conducted in making such a determination. The proposed rules would not have required an issuer that determined that its conflict minerals did not originate in the Covered Countries, based on its reasonable country of origin inquiry, to provide any further disclosures. We also proposed that an issuer include brief additional disclosure in the body of the annual report if the issuer's conflict minerals originated in the Covered Countries or if the issuer could not determine that its conflict minerals did not originate in the Covered Countries, based on its reasonable country of origin inquiry. As proposed, these rules would have required an issuer to disclose that its conflict minerals originated in the Covered Countries, or that it was unable to conclude that its conflict minerals did not originate in the Covered Countries, that its Conflict Minerals Report had been furnished as an exhibit to the annual report, that the Conflict Minerals Report, including the certified independent private sector audit, was publicly available on the issuer's Internet website, and the issuer's Internet address on which the Conflict Minerals Report and audit report were located.

The Conflict Minerals Statutory Provision requires that each issuer make its Conflict Minerals Report available to the public on the issuer's Internet website.[250] Consistent with the statute, we proposed rules to require an issuer to make such a report, including the certified audit report, available to the public by posting the text of the report on its Internet website. As proposed, the rules would require that the text of the Conflict Minerals Report remain on the issuer's website at least until it filed its subsequent annual report. Although the proposed rules would have required an issuer that furnished a Conflict Minerals Report to provide some disclosures in the body of its annual report regarding that report, we would not have required that an issuer post this disclosure on its website. We believed this was appropriate because any information disclosed in the body of the annual report would also be included in the Conflict Minerals Report, which would have been required to be posted on the issuer's Internet website.

**b. Comments on the Proposed Rules**

We received mixed comments on the proposal. While many

[250] See Exchange Act Section 13(p)(1)(E), which is entitled "Information Available to the Public" and states that "[e]ach person described under paragraph (2) shall make available to the public on the Internet website of such person the information disclosed by such person under subparagraph (A)."

commentators believed that the final rule should not require an issuer's conflict minerals information to be provided in that issuer's annual report,[251] other commentators believed that an issuer's conflict minerals information should be provided in that issuer's annual report, as proposed.[252] Commentators that did not want the conflict minerals information included in the annual report generally agreed that the information should be provided either in a newly created report or form, or in a current report on Form 8-K[253] or Form 6-K,[254] instead.[255] A small number of commentators stated that an issuer's conflict minerals information should be provided solely on its Internet website.[256] Some commentators suggested that the final rule should allow issuers to submit their conflict minerals information on a separate form or in a current report, noting that the Conflict Minerals Statutory Provision does not require explicitly that the information be submitted in a Form 10-K, Form 20-F, or Form 40-F annual report.[257] As one commentator noted, this requirement contrasts with the one in Section 1503 of the Act,[258] which states that

[251] See, e.g., letters from AdvaMed I, AngloGold, Barrick Gold, Cleary Gottlieb, Corporate Secretaries I, CTIA, Davis Polk, Ford Motor Company (Mar. 2, 2011) ("Ford"), Industry Group Coalition I, ITIC I, Japanese Trade Associations, JVC et al. II, NAM I, NAM III, NCTA, NMA II, NY State Bar, Roundtable, SEMI, Taiwan Semi, and Tiffany.

[252] See, e.g., letters from Earthworks, Enough Project I, Global Witness I, Methodist Pension, Peace, and TIAA-CREF.

[253] 17 CFR 249.308.

[254] 17 CFR 249.306.

[255] See, e.g., letters from AdvaMed I, AngloGold, Barrick Gold, Cleary Gottlieb, Davis Polk, Ford, ITIC I, JVC et al. II, NAM I, NMA II, NY State Bar, and Taiwan Semi.

[256] See letters from Corporate Secretaries I, CTIA, NCTA, and Tiffany.

[257] See, e.g., letters from AngloGold, ITIC I, JVC et al. II, and NAM I. Exchange Act Section 13(p)(1)(A) requires only that issuers "disclose annually" their conflict minerals information.

[258] Section 1503 of the Act.

mine safety disclosure be provided in "each periodic report filed with the Commission under the securities laws."[259] Therefore, these commentators reasoned that if Congress intended the Conflict Minerals Statutory Provision to require an issuer to provide the conflict minerals information in the annual report on Forms 10-K, 20-F, or 40-F, Congress would have used language similar to that in Section 1503.

Certain commentators asserted that the subject matter underlying the conflict minerals information is both very specialized and substantively different from the financial and business information in the annual report on Forms 10-K, 20-F, or 40-F.[260] Some of these commentators stated that the existing Exchange Act reporting system is designed to provide investors with material information from a financial perspective, whereas the Conflict Minerals Statutory Provision uses the securities disclosure laws to provide conflict mineral supply chain information for the purpose of stopping the humanitarian crisis in the Covered Countries.[261] Commentators suggested that the processes with which to obtain and provide conflict minerals information should be different from those processes developed for current year-end reporting.[262]

Other commentators argued that the disclosures required by the final rule should be treated no differently than other disclosures required by the Exchange Act.[263] In this regard, one such commentator agreed that the final rule should require that an issuer's

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259 See letter from AngloGold.

260 See, e.g., letters from Barrick Gold, CEI I, Cleary Gottlieb, Davis Polk, Ford, ITIC I, JVC et al. II, NAM I, NMA II, NY State Bar, PCP, Taiwan Semi, and SEMI.

261 See, e.g., letters from CEI I, NY State Bar, and Taiwan Semi.

262 See letters from Davis Polk and NAM I.

263 See letters from CRS I, Global Witness I, Methodist Pension, Sen. Durbin / Rep. McDermott, and SIF I.

conflict minerals information be included in the issuer's annual report because such a requirement is inherent in the policy goals underlying the Conflict Minerals Statutory Provision and would foster consistency in the form, location, and timing of the information.[264] Similarly, another such commentator stated that not requiring conflict minerals information in the annual report on Forms 10-K, 20-F, or 40-F would inhibit the public's ability to monitor an issuer's use of conflict minerals and allow issuers to hide their conflict minerals information.[265] In this regard, a number of commentators believed that there is little or no difference in the purposes of the Conflict Minerals Statutory Provision and the rest of the Exchange Act, in that both require the disclosure of meaningful supply chain and reputational information about an issuer for the benefit of investors.[266] For example, the co-sponsors of the legislation stated explicitly that the purposes of the Conflict Minerals Statutory Provision and the rest of the Exchange Act are "very much the same" because they both "'assure a stream of current information about an issuer for the benefit of purchasers and for the public.'"[267] As another example, a commentator asserted that "conflict minerals disclosures are material to investors and will inform and improve an investor's ability to assess social (i.e., human rights) and reputational risks in an issuer's supply chain."[268]

Some commentators were concerned about providing conflict minerals

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[264] See letter from Global Witness I.

[265] See letter from Peace.

[266] See, e.g., letters from CRS I, FRS, Global Witness I, Methodist Pension, Sen. Durbin / Rep. McDermott, Sen. Leahy et al., SIF I, and SIF II.

[267] See letter from Sen. Durbin / Rep. McDermott.

[268] See letter from SIF I.

information in the annual report on Forms 10-K, 20-F, or 40-F due to the timing of filing an annual report.[269] These commentators noted that the increased burden on issuers in collecting and reporting conflict minerals information could cause those issuers to be unable to file their annual reports in a timely manner. Some commentators offered an alternative scheme in which an issuer would be permitted to provide its conflict mineral information on either a new report or form, an amended annual report, or a current report on Form 8-K or Form 6-K within a certain number of days following the end of the issuer's fiscal year.[270] A few of these commentators[271] pointed out that the Commission permits delays in providing certain information on an annual report, such as with prospective incorporation by reference of information from an issuer's proxy statement under General Instruction G.(3) of Form 10-K[272] and prospective incorporation by reference of separate financial statements of unconsolidated entities under Item 3-09 of Regulation S-X.[273] Commentators proposed a variety of time periods, including 120, 150, and 180 days after an issuer's fiscal year-end, in which an issuer could be required to provide its conflict minerals information as part of its annual report.[274] Similarly, as discussed in greater detail below, some commentators suggested that the final rule should consider a single start and end date for the reporting period for all companies, regardless

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[269] See, e.g., letters from AngloGold, Cleary Gottlieb, CTIA, Ford, ITIC I, NAM I, NY State Bar, Roundtable, and SEMI.

[270] See letters from AngloGold, Cleary Gottlieb, CTIA, IPC I, ITIC I, JVC et al. II, NAM I, NY State Bar, Roundtable, and SEMI.

[271] See letters from Cleary Gottlieb and NY State Bar.

[272] General Instruction G.(3) of Form 10-K [17 CFR 249.310].

[273] Item 3-09 of Regulation S-X [17 CFR 210.3-09].

[274] See letters from AngloGold, CTIA, ITIC I, NAM I, Roundtable, and SEMI.

of their particular fiscal year,[275] and one of these commentators recommended that this one year period coincide with the calendar year.[276]

Additionally, some commentators were concerned about the liability of the principal executive offers, principal financial officers, and auditors who must certify an annual report under Sections 302[277] and 906[278] of the Sarbanes-Oxley Act if the rule requires that an issuer provide its conflict minerals information in its filed annual report.[279] In this regard, one commentator stated that, if the final rule requires an issuer to provide conflict minerals information in its annual report, the Commission should amend rules 13a-14(a) and (b)[280] and 15d-14(a) and (b)[281] under the Exchange Act to acknowledge that the various officer certifications required by those rules do not extend to any conflict minerals information provided either in or as an exhibit to the annual report.[282] Another commentator stated that, if we required conflict minerals disclosure in

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[275] See letters from Advanced Micro Devices, Inc., Africa Faith and Justice Network, Boston Common Asset Management, LLC, Calvert Asset Management Co., Inc., Congo Global Action, Enough Project, Falling Whistles, Free the Slaves, Future 500, General Electric Company, Global Witness, Hewlett-Packard Company, Interfaith Center on Corporate Responsibility, Jantzi-Sustainalytics, Jesuit Conference, Jewish World Watch, Mercy Investment Services, Inc., Microsoft Corporation, Royal Philips Electronics, Trillium Asset Management, Unity Minerals, US SIF: The Forum for Sustainable and Responsible Investment (Aug. 22, 2011) ("MSG II") and State II.

[276] See letter from MSG II ("We respectfully request that the SEC rule synchronize the timing for the information contained in the Conflict Minerals Reports from all issuers on a calendar year basis. The MSG recommends that all issuers begin exercising and reporting due diligence on the source and chain of custody for the subject minerals used in their products on a common calendar date.").

[277] Pub. L. 107-204, 116 Stat. 745, Sec. 302 (2002).

[278] Pub. L. 107-204, 116 Stat. 745, Sec. 906 (2002).

[279] See, e.g., letters from ITIC I, NMA II, and Taiwan Semi.

[280] Rule 13a-14(a) [17 CFR 240.13a-14(a)] and Rule 13a-14(b) [17 CFR 240.13a-14(b)].

[281] Rule 15d-14(a) [17 CFR 240.15d-14(a)] and Rule 15d-14(b) [17 CFR 240.15d-14(b)].

[282] See letter from NY State Bar.

the existing annual reports, we should include "a clear statement in the rules or the adopting release that the officer certifications required to be included as exhibits to the existing annual reports would not apply to the conflict minerals disclosure."[283] Also, some commentators were concerned about the negative effects that providing the information in the annual report on Forms 10-K, 20-F, or 40-F would have on form or other eligibility, incorporation by reference into Securities Act filings, and home country reporting in the case of foreign private issuers.[284]

Some commentators indicated that, regardless of where the information was provided, they wanted the conflict minerals information in a location that was easily available to the public,[285] or on the websites of both the issuer and the Commission.[286] In this regard, certain commentators recommended that the final rule require an issuer to post its Conflict Minerals Reports and/or its audit reports on its Internet website, as we proposed.[287] However, some of these commentators suggested that the final rule should require an issuer to keep that information on its Internet website longer than until the issuer filed its subsequent annual report.[288] Other commentators noted that the final rule

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[283] See letter from Cleary Gottlieb.

[284] See, e.g., letters from Barrick Gold, Cleary Gottlieb, Corporate Secretaries I, Davis Polk, ITIC I, NMA II, NY State Bar, and WGC II. But see letter from Global Witness I (stating that conflict minerals information should be incorporated by reference into Securities Act filings).

[285] See, e.g., letters from Episcopal Conference of Catholic Bishops of the DRC (Apr. 5, 2011) ("CENCO I") and Good Shepherd.

[286] See, e.g., letter from Catholic Charities.

[287] See letters from CRS I, Douglas Hileman Consulting LLC (Oct. 31, 2011) ("Hileman Consulting"), Howland, NEI, SEMI, SIF I, and TriQuint I.

[288] See letters from Hileman Consulting (suggesting "more than the proposed one year"), NEI (suggesting "issuers to post several years worth of reports on their websites"), SIF I (suggesting that an "issuer should be required to keep posted its Conflict Minerals Report and audit reports on its Internet website for five

should not require an issuer to post its audit report online[289] because, as one of the commentators noted,[290] such a requirement would increase costs without increasing benefits.

Finally, some commentators suggested that the final rule should address how an issuer must handle a situation in which it acquires or otherwise obtains control over a company that manufactures or contracts to manufacture products with conflict minerals necessary to the functionality or production of products that previously had not been obligated to provide conflict minerals information to us.[291] These commentators noted that the acquired company may not have any processes in place to determine the origin of conflict minerals in its products and, therefore, the acquiring issuer would most likely need a "reasonable amount of time"[292] to establish those processes before it could provide an accurate specialized disclosure report that included the acquired company's supply chain. Some commentators recommended that the issuer not be required to report on the products manufactured by the acquired company until the end of the first reporting period that begins no sooner than eight months after the effective date of the acquisition.[293] One

years"), and TriQuint I (suggesting that an issuer's Conflict Minerals Reports should be posted on its website "for 10 years after the issuer's products were last sold on the open market").

289 See letters from AngloGold and NMA II.

290 See letter from AngloGold.

291 See, e.g., letters from ABA, Industry Group Coalition I, Industry Group Coalition II, NAM I, and Semiconductor.

292 Letter from Semiconductor.

293 See letters from Industry Group Coalition I (suggesting an eight month lead-in period because it is similar to the time that will elapse between the adoption of final rules implementing the Act and the commencement of the reporting period applicable to calendar-year filers, and that time period is necessary to allow sufficient time for the acquiring issuer to implement its conflict minerals reasonable inquiry and

commentator suggested that the issuer not be required to report on the products manufactured by the acquired company until the end of the first reporting period that begins no sooner than 18 months from the date of the acquisition.[294] Another commentator recommended that the issuer not be obligated to report with respect to the products manufactured by or for the acquired entity "until the first fiscal year beginning after the fiscal year in which the acquisition is consummated."[295]

### c. Final Rule

After considering the comments, we are revising the proposed rules to require that an issuer provide its conflict minerals information in a new report on a new Exchange Act form. As proposed, however, the final rule requires an issuer to provide its Conflict Minerals Report as an exhibit, and not in the body of the new report. In this regard, we continue to believe that providing the Conflict Minerals Report as an exhibit to the specialized disclosure report will enable anyone accessing the EDGAR system to determine quickly whether an issuer provided a Conflict Minerals Report with its specialized disclosure report.

We proposed requiring disclosure regarding conflict minerals in an issuer's annual report because we believed that this approach would be less burdensome than requiring that an issuer provide a separate report. Based on the comments we received, however, it appears that issuers will find it less burdensome to provide their conflict

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due diligence processes throughout the supply chain of the acquired firm), NAM I (same), and Semiconductor (same).

[294] See letter from Industry Group Coalition II. See also letters from Industry Group Coalition I, NAM I, and Semiconductor.

[295] See letter from ABA.

minerals information on a new report that is separate from the annual report and due later than the annual report. For example, one commentator explained that "between an issuer's fiscal year end and the date the issuer is required to file its audited annual financial statements, the issuer's accounting and financial reporting teams focus their resources on preparing the issuer's annual report," so "[r]equiring the conflict minerals disclosure to be furnished at the same time as the issuer's Exchange Act annual report would put further strain on these resources at a time when they are likely already to be operating near full capacity."[296] Another commentator noted that issuers are going to be required to utilize "significantly different processes to comply with the new reporting requirement that are outside the scope of processes developed for regular year-end reporting, and it may be a burden to complete the necessary inquiry and due diligence pertaining to conflict minerals on the same timetable as" an annual report.[297]

We considered commentators' arguments that it would be easier for investors to locate the information in Forms 10-K, 20-F, and 40-F. We believe, however, that new Form SD should provide ready access to the information. Indeed, it may be easier for investors to find the information when it is included in the new Form SD, rather than as one of potentially dozens of exhibits in a voluminous Form 10-K, Form 20-F, or Form 40-K.[298] Therefore, the final rule requires an issuer with conflict minerals necessary to

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[296] Letter from AngloGold.

[297] Letter from NAM I.

[298] Under the proposed rules, an issuer would have been required to furnish its conflict minerals information in its annual report on Form 10-K, Form 20-F or Form 40-F. As such, investment companies that are registered under the Investment Company Act of 1940 [15 U.S.C. 80a et seq.] ("registered investment companies") would not have been subject to the disclosure requirement because those companies are not required to file Form 10-K, Form 20-F or Form 40-F. Our decision to require this

the functionality or production of a product it manufactures or contracts to be manufactured to provide us a specialized disclosure report on Form SD by May 31 of each year, reporting on the preceding calendar year. The specialized disclosure report is due later than when an annual report is due for calendar year end issuers so as not to interfere with such issuer's preparation of its Exchange Act annual report, as requested by a number of commentators.[299] Also, as discussed in greater detail below, the final rule requires each issuer to provide its conflict minerals information for each calendar year, rather than its fiscal year.

We agree with the comments we received that a reasonable amount of additional time to submit the conflict minerals information is appropriate where an issuer acquires or otherwise obtains control over a company that manufactures or contracts to manufacture products with conflict minerals necessary to the functionality or production of those products that previously had not been obligated to provide conflict minerals information to us. We have added an instruction to the final rule to reflect this delay. Therefore, the final rule allows an issuer to delay the initial reporting period on the products manufactured by the acquired company until the first calendar year beginning no sooner than eight months after the effective date of the acquisition. This option

disclosure in a new form is not intended to change the scope of companies subject to the disclosure requirement. Therefore, consistent with the proposal, registered investment companies that are required to file reports on Form N-CSR or Form N-SAR pursuant to Rule 30d-1 under the Investment Company Act (17 CFR 270.30d-1) will not be subject to the final rule.

[299] See, e.g., letters from AngloGold, Cleary Gottlieb, CTIA, Ford, ITIC I, NAM I, NY State Bar, Roundtable, and SEMI.

appears to be a reasonable approach based on some of the comments we received.[300] We note that a shorter period, such as requiring an issuer to report with respect to the products manufactured by or for the acquired entity during the first fiscal year beginning after the fiscal year in which the acquisition is consummated, may leave an issuer that acquires a company late in the year with an insufficient amount of time to establish systems to gather and report on the conflict minerals information.

Additionally, we are modifying the proposed rules regarding how long an issuer must keep its conflict minerals disclosure or its Conflict Minerals Report available on the issuer's Internet website to reflect that the information is not to be included in an issuer's annual report on Form 10-K, Form 20-F, or Form 40-K. The proposed rules would have required an issuer to keep its conflict minerals information on its Internet website until its subsequent annual report was filed. We intended this period to last only one year because, whether or not the issuer had any conflict minerals information to provide in its subsequent annual report, the issuer had to file the subsequent annual report one year after its prior annual report or cease to be a reporting issuer. However, with the final rule requiring an issuer to provide its conflict minerals information in a specialized disclosure report on Form SD, the period between specialized disclosure reports may be more than one year if an issuer has no reportable conflict minerals in its subsequent calendar year. If we did not modify the proposed rules, such an issuer may have been required to keep its conflict minerals information on its Internet website for more than one year, possibly indefinitely. Therefore, the final rule specifies that an issuer must make its conflict

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[300] See, e.g., letters from Industry Group Coalition I, Industry Group Coalition II, NAM I, and Semiconductor.

minerals disclosure or its Conflict Minerals Report available on the issuer's Internet website for one year. In response to concerns expressed by commentators that the information should be required to be mandated longer, we note that the issuer's Form SD with the Conflict Minerals Report will be available on EDGAR indefinitely, so the information will continue to be widely available.

In another release we are issuing today, we are requiring issuers to disclose certain resource extraction payment information on Form SD.[301] Because of the order of the releases, we are adopting the form in this release and amending it in the resource extraction release. We intend, however, for the form to be used equally for these two separate disclosure requirements.

### 2. "Filing" of Conflict Minerals Information

#### a. Proposed Rules

The proposed rules would have required an issuer's conflict minerals information to be provided in the issuer's annual report on Form 10-K, Form 20-F, or Form 40-F, as applicable, and the Conflict Minerals Report to be included as an exhibit to the issuer's annual report. Certain proposed item requirements would have instructed an issuer to furnish its Conflict Minerals Report as an exhibit to its annual report. Additionally, as proposed, an issuer's Conflict Minerals Report, which would have included the independent private sector audit report, would not be "filed" for purposes of Section 18 of the Exchange Act and thus would not be subject to potential liability of that section of the Exchange Act, unless the issuer stated explicitly that the Conflict Minerals Report and

[301] Disclosure of Payments by Resource Extraction Issuers, Release No. 34-67717 (Aug. 22, 2012).

the independent private sector audit report were filed under the Exchange Act. Instead, these documents would only have been furnished to the Commission. Similarly, as proposed, the rules would not have considered the Conflict Minerals Report and the independent private sector audit report to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the issuer specifically incorporated them by reference into the documents. As noted above and in the Proposing Release, furnishing the Conflict Minerals Report would not have subjected the issuer to Section 18 liability,[302] but the issuer would still have had liability for its conflict minerals information. Under Exchange Act Section 13(p)(1)(C), a failure to comply with the Conflict Minerals Statutory Provision would have rendered the issuer's due diligence process "unreliable," and, therefore, the Conflict Minerals Report would "not satisfy" the proposed rules.[303] In this regard, as proposed, an issuer that failed to comply with the proposed rules would have been subject to liability for violations of Exchange Act Sections 13(a) or 15(d), as applicable.[304]

**b. Comments on the Proposed Rules**

A number of commentators stated specifically that the final rule should, as proposed, require an issuer to "furnish" rather than "file" its conflict minerals information.[305] Many of these commentators believed that the nature and purpose of the

[302] 15 U.S.C. 78r.

[303] See Exchange Act Section 13(p)(1)(C).

[304] 15 U.S.C. 78m(a) and 15 U.S.C. 78o(d).

[305] See, e.g., letters from AngloGold, Barrick Gold, Cleary Gottlieb, Corporate Secretaries I, Deloitte & Touche LLP (Mar. 2, 2011) ("Deloitte"), Ford, ITIC I, JVC et al. II, NAM III, NMA II, NY State Bar, Taiwan Semi, and WGC II.

conflict minerals disclosure is qualitatively different from the other disclosure required under Exchange Act Section 13 and the conflict minerals information is not material to investors.[306] As one commentator explained, "[n]othing in the statute itself suggests that the 'reasonable' investor would find this information to be important in deciding whether to buy or sell" an issuer's securities, which is "the touchstone of materiality under the federal securities laws."[307] However, this commentator acknowledged that "socially conscious investors might well factor this information into an investment decision."[308] Some commentators asserted that the conflict minerals information is different from other information in required filings, so the conflict minerals information should be "furnished."[309] Other commentators noted that, if the conflict minerals information is material to a reasonable person's investment decision, it would have to be disclosed in an issuer's filings even without the Conflict Minerals Statutory Provision, so any other information regarding conflict minerals should be "furnished."[310] Another commentator recommended that the conflict minerals information should be "furnished" because, whereas the data used to generate the financial statements in issuers' "filed" periodic reports are generally within their control and subject to internal controls, issuers would be required to rely on third parties (suppliers, smelters, etc.) for their conflict minerals data

[306] See, e.g., letters from AngloGold, Barrick Gold, Cleary Gottlieb, Ford, ITIC I, JVC et al. II, NMA II, NY State Bar, and Taiwan Semi.

[307] See letter from JVC et al. II.

[308] See id.

[309] See, e.g., letters from AngloGold, Barrick Gold, Cleary Gottlieb, Ford, ITIC I, JVC et al. II, NMA II, NY State Bar, and Taiwan Semi.

[310] See letter from AngloGold and NMA II.

that are mostly beyond the issuer's control.[311]

Some commentators argued that the conflict minerals information should be "furnished" so that Exchange Act Section 18 liability would not attach to the conflict minerals information.[312] One of these commentators asserted that Section 18 liability should not be available because there is no indication that Congress intended for an issuer's conflict minerals information to be subject to such liability.[313] In this regard, some commentators contended that, if "furnished," issuers' conflict minerals information would still receive significant attention and scrutiny, and the issuers' disclosures regarding this information will still be subject to liability sufficient enough to deter abuse.[314] The commentators pointed out that issuers would still be liable for any materially false or misleading statements under the antifraud provisions of the federal securities laws, including, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[315] They indicated further that failure to comply with the Conflict Minerals Statutory Provision would render the issuer's due diligence "unreliable" and, therefore, the Conflict Minerals Report would not satisfy the final rule, which would subject the issuer to liability for violations of Exchange Act Sections 13(a) or 15(d), as applicable.[316]

Conversely, other commentators indicated that the final rule should require an

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311 See letter from Ford.

312 See letters from Barrick Gold, Cleary Gottlieb, NMA II, Society of Corporate Secretaries and Governance Professionals (Aug. 16, 2011) ("Corporate Secretaries III"), and WGC II.

313 See letter from the WGC II.

314 See letters from Barrick Gold, Ford, and JVC et al. II.

315 See letters from Barrick Gold and JVC et al. II.

316 See letters from Ford and JVC et al. II.

issuer to "file" its conflict minerals information.[317] Two of the co-sponsors of the statutory provision noted that Congress intended for an issuer's conflict minerals information, particularly the Conflict Minerals Report, to be "filed" rather than "furnished" so that the information would be subject to the liability provisions in Section 18 of the Exchange Act and, thereby, allow for private sector remedies for false and misleading statements.[318] These co-sponsors asserted that, in the Proposing Release, we incorrectly reasoned that the Conflict Minerals Statutory Provision's requirement that an issuer "submit" its Conflict Minerals Report means that Congress intended that the information be "furnished" instead of "filed." They noted that the term "furnish" is included throughout the Act 41 times, but that term is "expressly not used in Section 1502," which demonstrates that "Congress intended for the word 'submit' to be synonymous with 'filed,' not 'furnished.'"[319]

Similarly, another comment letter written by other members of Congress also emphasized that it was Congress's legislative intent to the Conflict Minerals Report be "filed" not "furnished."[320] The letter stated that it was made clear "during the legislative process, meetings with the SEC, and in written comments to the Commission that Section 1502 was designed as a transparency measure to provide investors and the public the

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[317] See, e.g., letters from Bario-Neal, Brilliant Earth, Columban Center et al., Earthworks, Enough Project I, Global Witness I, Hacker Jewelers, Hoover & Strong, Metalsmiths, Sen. Durbin / Rep. McDermott, SIF II, TakeBack, TIAA-CREF, and World Vision US and World Vision DRC (Feb. 21, 2012) ("World Vision II").

[318] See letter from Sen. Durbin / Rep. McDermott.

[319] See id.

[320] See letter from Sen. Leahy et al.

information needed to make informed choices."[321] Therefore, according to the letter, "[p]rotecting investor interests by making companies liable for fraudulent or false reporting of conflict minerals is critical – so the reports must be 'filed,' not 'furnished.'"[322]

Further, commentators asserted that a plain reading of the Conflict Minerals Statutory Provision demonstrates that Congress intended that the term "submit" to mean "file."[323] The commentators argued that "submit" means "file" in the provision because new Exchange Act Section 13(p)(2)(A) states that conflict minerals disclosure is required if conflict minerals are necessary to the functionality or production of a product manufactured by a person described and the person described is required to "file" reports with us pursuant to the Conflict Minerals Statutory Provision. Also, one of the commentators noted that the term "furnish" is not in the text of the provision.[324]

Additionally, some commentators asserted that requiring the conflict minerals information be "filed" would benefit investors by making an issuer's conflict minerals information more transparent, accessible, accurate, and complete. In this regard, one of these commentators suggested that requiring the conflict minerals information to be "filed" would allow for private rights of action, which would permit investors to seek remedies for material misstatements regarding conflict minerals disclosures, and provide

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[321] Id.

[322] Id.

[323] See letters from Global Witness I and Enough Project I.

[324] See letter from Global Witness I.

an incentive for issuers and others to conduct an appropriate due diligence.[325] Another commentator noted that requiring issuers to "file" their conflict minerals information "promotes greater transparency, makes Section 1502 more effective," and helps "facilitate access to this information."[326] In a further comment letter, a group of investors indicated that requiring issuers to "file" their conflict minerals information would "allow investors greater assurance that conflict minerals disclosure is as comprehensive, transparent and accurate as possible."[327]

Finally, some commentators argued that the conflict minerals information is material and, therefore, should be "filed."[328] A group of investors in one comment letter noted that the conflict minerals information is material to an investor in evaluating its investment decision, so the information should be "filed."[329] Specifically, the letter stated that "[g]iven the materiality of the data in evaluating a company's risk, we urge the Commission to require all information outlined in the proposed rule to be filed in the body of the annual report rather than furnished as an exhibit."[330] Also, in another comment letter, an institutional investor indicated that the conflict minerals information is material to an investment decision and, therefore, "as material information[,] this report should be filed,

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[325] See id.

[326] See letter from Enough Project I.

[327] See letter from SIF II.

[328] See letters from Global Witness I, SIF II, and TIAA-CREFF.

[329] See letter from SIF II.

[330] Id.

not furnished as proposed by the Commission."[331] Moreover, one commentator argued that allowing the conflict minerals information to be "furnished" instead of "filed" would "send a regrettable signal that the Commission believes these disclosures to be of lesser importance at the very moment that issuers, regulators, investors, and governments around the world are looking to the Commission to help establish the way forward," which would "scale back the vigor of issuer compliance and undermine the entire purpose of the statute" and "undermine the goals of ending the resource-related violence in the DRC and providing meaningful and reliable disclosures to the American consumer and investor."[332]

**c. Final Rule**

Although the proposal would have required the conflict minerals information to be "furnished," after considering the comments, the final rule we are adopting requires issuers with necessary conflict minerals to "file" the conflict minerals information provided in their specialized disclosure reports, including any Conflict Minerals Reports and independent private sector audit reports.[333] As discussed above, commentators disagreed as to whether the required information should be "furnished" or "filed,"[334] and in our view the Conflict Minerals Provision is ambiguous on this question. In reaching

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[331] See letter from TIAA-CREF.

[332] See letter from Global Witness I.

[333] 15 U.S.C. 78r.

[334] Compare letters from AngloGold, Barrick Gold, Cleary Gottlieb, Corporate Secretaries I, Deloitte, Ford, ITIC I, JVC et al. II, NAM III, NMA II, NY State Bar, Taiwan Semi, and WGC II (supporting a requirement to "furnish" the disclose), with letters from Bario-Neal, Brilliant Earth, Columban Center et al., Earthworks, Enough Project I, Global Witness I, Hacker Jewelers, Hoover & Strong, Metalsmiths, Sen. Durbin / Rep. McDermott, SIF II, TakeBack, TIAA-CREF, and World Vision II (supporting a requirement to "file" the disclosure).

our conclusion that the information should be "filed" instead of "furnished," we note particularly that although Section 13(p)(1)(a) states that a Conflict Minerals Report should be "submitted" to the Commission, the definition of a "person described," who is required to submit a report, uses the term "file." This reference in the statute indicates that the reports should be filed.

Additionally, commentators asserted that allowing the information to be "furnished" would diminish the importance of the information,[335] and that requiring the information to be "filed" would enhance the quality of the disclosures.[336] Some commentators argued that the conflict minerals information should not be treated as of lesser importance than other required disclosures,[337] and another commentator indicated specifically that the conflict minerals information is qualitatively similar to disclosures that are required to be "filed."[338]

Other commentators supporting the proposal that the disclosure be "furnished" argued that the information is not material to investors,[339] while some argued that it was.[340] Given the disagreement, and that materiality is a fact-specific inquiry, we are not persuaded that this is a reason to provide that the information should be "furnished." Additionally, we appreciate the comments that the conflict minerals information should

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[335] See letter from Global Witness I.

[336] See letters from Enough Project I and SIF II.

[337] See letter from Global Witness I.

[338] See Sen. Durbin / Rep. McDermott.

[339] See letters from AngloGold, Barrick Gold, Cleary Gottlieb, Corporate Secretaries I, Deloitte, Ford, ITIC I, JVC et al. II, NAM III, NMA II, NY State Bar, Taiwan Semi, and WGC II.

[340] See letters from Sen. Leahy et al., SIF I, SIF II, and TIAA-CREF.

be "furnished" because issuers should not be held liable for the information when they are required to rely on third parties for their conflict minerals data and direct knowledge of relevant facts may not be available to them.[341] We note, however, that section 18 does not create strict liability for filed information. Rather, it states that a person shall not be liable for misleading statements in a filed document if it can establish that it acted in good faith and had no knowledge that the statement was false or misleading.[342]

Moreover, as discussed below, the final rule will include a transition period in which issuers that are required to perform due diligence and are unable to determine that their conflict minerals did not originate in the Covered Countries or unable to determine that their conflict minerals that originated in the Covered Countries did not directly or indirectly finance or benefit armed groups in the Covered Countries may describe their products with such conflict minerals as "DRC conflict undeterminable." We believe this period will allow issuers sufficient time to obtain more data on, and control over, their supply chain through revised contracts with suppliers and smelter verification.

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[341] See letter from Ford.

[342] Exchange Act Section 18(a) provides: "Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant." A plaintiff asserting a claim under Section 18 would need to meet the elements of the statute to establish a claim, including reliance and damages. In addition, we note that issuers that fail to comply with the final rule could also be violating Exchange Act Sections 13(a) and (p) and 15(d), as applicable. Issuers would also be subject to potential liability under Exchange Act Section 10(b) [15 U.S.C. 78j] and Rule 10b-5 [17 CFR 240.10b-5], promulgated thereunder, for any false or misleading material statements in the information disclosed pursuant to the rule.

confirmations, thereby mitigating this liability concern.[343]

### 3. Uniform Reporting Period

#### a. Proposed Rules

The Conflict Minerals Statutory Provision requires, and we proposed to require, that issuers provide their initial conflict minerals disclosure and, if necessary, their initial Conflict Minerals Report after their first full fiscal year following the adoption of our final rule.[344] The report would be required to cover that first full fiscal year.

#### b. Comments on the Proposed Rules

We included a request for comment asking whether our rules should allow individual issuers to establish their own criteria for determining which reporting period to cover in any required conflict minerals disclosure or Conflict Minerals Report, provided that the issuers are consistent and clear with their criteria from year-to-year. Some commentators agreed that the final rule should allow individual issuers flexibility in choosing the appropriate criteria for determining the reporting period in which conflict minerals disclosures are made, provided that the issuer's methodology is clear.[345] Other commentators, however, asserted that the final rule should require that the conflict minerals reporting period correspond to the issuer's fiscal year in its annual report.[346]

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[343] As discussed above, requiring the disclosure in a new form, rather than in issuers' Exchange Act annual reports, should alleviate some commentators' concerns about the disclosure being subject to the officer certifications required by Rules 13a-14 and 15d-14 under the Exchange Act.

[344] See Exchange Act Section 13(p)(1)(A) (stating that an issuer must "disclose annually, beginning with the [issuer's] first full fiscal year that begins after the date of promulgation of [our] regulations").

[345] See letters from Howland, IPC I, and NMA II.

[346] See letters from AngloGold and TIC.

We did not request comment specifically on whether an issuer's conflict minerals reporting period should correspond to an issuer's fiscal year. Even so, some commentators indicated that an issuer's annual reporting period for conflict minerals disclosure should not be based on its fiscal year but, instead, should be based on a one-year period that is the same for all issuers.[347] One of these commentators recognized that "synchronizing the timing for the information ... from all issuers on a calendar year basis ... would offer integrity and consistency throughout the various supply chains" and because "component manufacturers and others through the supply chain provide products for many customers who have different fiscal years, it would be more efficient and more accurate if the whole supply chain worked towards a common deadline."[348] Another commentator noted that a uniform calendar year reporting period "would clarify the reporting obligations, level the playing field among the various companies, and provide a clearer date of implementation for due diligence and related initiatives in the region."[349] A further commentator asserted that a "single reporting date will allow for increased efficiency and thus lower costs, without reducing the effectiveness of the regulations."[350]

**c. Final Rule**

After considering the comments, the final rule will require each issuer to provide its conflict minerals information on a calendar year basis regardless of any particular

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347 See letters from IPC II; Matheson II; MSG II; Multi-Stakeholder Group comprised of 29 issuers, non-governmental organizations, and investors (Nov. 10, 2011) ("MSG III"); and State II.

348 Letter from MSG II. See also letter from MSG III.

349 Letter from State II.

350 Letter from IPC II.

issuer's fiscal year end.[351] The final rule requires an issuer to provide its annual conflict minerals information in its specialized disclosure report on Form SD for every calendar year from January 1 to December 31 and the specialized disclosure report will be due to the Commission on May 31 of the following year. In this regard, the first reporting period for all issuers will be from January 1, 2013 to December 31, 2013, and the first specialized disclosure report must be filed on or before May 31, 2014.

We agree with the commentators that explained that burdens on participants in the supply chain could be reduced if our final rule adopted a uniform reporting period. This requirement allows component suppliers that are part of a manufacturer's supply chain to provide reports to their upstream purchasers regarding the conflict minerals in their components only once a year. Otherwise, if the due date of the Conflict Minerals Report was tied to an issuer's fiscal year end, as proposed, component suppliers could have to provide reports regarding the conflict minerals in their components on a continuous basis throughout the year because their customers may have different fiscal year ends. If a component supplier has numerous purchasers, it might have to provide separate reports regarding the conflict minerals in its components every month, or even more often, which could be very burdensome and costly.[352]

Additionally, requiring a uniform May 31 due date for the specialized disclosure

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[351] We are aware that Exchange Act Section 13(p)(1)(A) requires that we promulgate regulations requiring any "person described" to disclose annually its conflict minerals information, "beginning with the person's first full fiscal year that begins after the date of promulgation of such regulations." The Conflict Minerals Statutory Provision does not tie any required conflict minerals information to an issuer's annual report or its audited financial statements. Therefore, although the provision requires an issuer to begin reporting after an issuer's full fiscal year has cycled through, there is no requirement for the final rule's reporting period to correspond to an issuer's fiscal year.

[352] See letter from MSG II.

report responds to concerns raised by certain industry commentators that there would not be sufficient time in the period between the end of an issuer's fiscal year until its annual report is due to gather, report on, and have audited their conflict minerals information, as discussed above.[353] The specialized disclosure report will be due later than an Exchange Act annual report is due for calendar year end issuers so as not to interfere with an issuer's preparation of its Exchange Act annual report, as requested by commentators. Also, the final rule will require each issuer to provide its conflict minerals information for each calendar year, rather than its fiscal year. The May 31 due date is approximately 150 days after the calendar year end, which is consistent with a commentator's suggested due date for an issuer to provide us with its conflict minerals information.[354]

**4. Time Period for Providing Conflict Minerals Information**

**a. Proposed Rules**

The Conflict Minerals Statutory Provision requires issuers to provide the specified disclosure with respect to necessary conflict minerals "in the year for which such reporting is required."[355] We proposed that the date an issuer takes possession of a conflict mineral would determine which reporting year that issuer would have to provide its required conflict minerals information. Also, if an issuer contracted the manufacturing of a product in which a conflict mineral is necessary to the production of that product, but the conflict mineral would not be included in the product, the issuer would, under the

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[353] See, e.g., letters from AngloGold, Cleary Gottlieb, CTIA, Ford, ITIC I, NAM I, NY State Bar, Roundtable, and SEMI.

[354] See letter from AngloGold (suggesting that an issuer be required to provide its conflict minerals information on a Form 8-K or Form 6-K "within 150 calendar days after the issuer's fiscal year-end").

[355] Exchange Act Section 13(p)(1)(A).

proposal, have used the date it takes possession of the product to determine which reporting year the issuer would have to provide the required conflict minerals information.

### b. Comments on the Proposed Rules

Some commentators suggested that, as proposed, an issuer should be required to provide its conflict minerals information in the reporting period during which the issuer took possession of its conflict minerals.[356] Other commentators recommended, however, that the final rule should use some other determining factor.[357] Some commentators did not provide alternative factors to consider in determining for which annual reporting period an issuer must report its conflict minerals information, but stated only that an issuer should be allowed the flexibility to establish its own criteria for determining when an issuer would be required to provide information on the conflict minerals it obtained.[358] Other commentators provided alternative factors, such as the year in which the mineral is purchased, the year the issuer takes possession and ownership of the mineral, the year the mineral is processed, or the year the product containing conflict minerals is produced or placed on the market.[359]

### c. Final Rule

After considering the comments, the final rule is revised from the proposal such that possession is not the determining factor for deciding for which reporting year an

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[356] See, e.g., letters from Cleary Gottlieb, ITIC I, and WGC II.

[357] See, e.g., letters from AngloGold, NAM I, RJC, and TIC.

[358] See, e.g., letters from Howland, IPC I, and NMA II.

[359] See, e.g., letters from AngloGold, NAM I, RJC, and TIC.

issuer has to provide its required conflict minerals information. We are making this revision because we agree, as one commentator noted, that the "statutory requirement to report is triggered not by acquisition or possession of conflict minerals."[360] Instead, the final rule provides that an issuer must provide its required conflict minerals information for the calendar year in which the manufacture of a product that contains any conflict minerals is completed, irrespective of whether the issuer manufactures the product or contracts to have the product manufactured.[361] We believe this approach is appropriate because it should be relatively easy for an issuer to identify when the manufacture of a product is completed, as the issuer has a certain amount of control over this decision. Thus, this approach also allows issuers some flexibility in determining the reporting period. For example, if an issuer completes the manufacture of a product with conflict minerals necessary to the functionality or production of that product on December 30, 2018, the issuer must provide a specialized disclosure report regarding the conflict minerals in that product for the 2018 calendar year. However, if that issuer completes the manufacture of that same product on January 2, 2019, the issuer must provide a specialized disclosure report regarding the conflict minerals in that product for the 2019 calendar year.

This timeframe is the same for an issuer that contracts the manufacturing of its products. An issuer that contracts the manufacturing of a product must provide its required conflict minerals information for the calendar year in which the issuer's contract

[360] See letter from NAM I.

[361] See id. (recommending that, "[i]f the rule specifies a reporting trigger, it should be producing or placing on the market a product containing conflict minerals").

manufacturer completes the manufacturing of product. For example, if an issuer's contractor completes the manufacturing of the product with conflict minerals necessary to the functionality or production of that product on December 30, 2018, the issuer must provide a specialized disclosure report regarding the conflict minerals in that product for the 2018 calendar year, even if the issuer does not receive the product until January 2, 2019. However, if that issuer's contractor completes the manufacturing of that same product on January 2, 2019, the issuer must provide a specialized disclosure report regarding the conflict minerals in that product for the 2019 calendar year.

This outcome is the same for an issuer that manufactures the product using a component product with conflict minerals necessary to the functionality of the product that is manufactured by an independent third party. If the manufacturer of the product completes the product that incorporates the component product with necessary conflict minerals on December 30, 2018, the issuer that manufactured the product must provide a specialized disclosure report regarding the conflict minerals in that product for the 2018 calendar year. However, the reporting period of the independent third party manufacturer of the component product, if it is a reporting issuer, is not determined by when the manufacturing of the subsequent product containing its component product is completed. Instead, the reporting period for that component product manufacturing issuer is determined by when it completes the manufacturing of the component product. Therefore, an issuer that completes the manufacture of a component product on December 30, 2018, must provide a specialized disclosure report regarding the conflict minerals in that completed component product for the 2018 calendar year.

**5. Conflict Minerals Already in the Supply Chain**

a. Proposed Rules

The proposed rules did not discuss specifically how an issuer would handle any conflict minerals already in the supply chain at the time our final rule takes effect, including existing stockpiles of conflict minerals. The Proposing Release, however, requested comment on this point.

b. Comments on the Proposed Rules

Almost all commentators that discussed the topic recommended that an issuer's existing stockpile of conflict minerals should be exempt from the final rule.[362] One commentator explained, that "[c]ategorizing existing stock as 'conflict' simply because the mineral was mined before SEC rules have been agreed and published serves no purpose in furthering the aims of the legislation and would cause serious financial loss to the holders of that stock[pile]."[363] In this regard, one commentator asserted that "[s]tockpiled minerals may have originated in mines that support the conflict; however, it would be impractical to ask companies to trace the origin of these minerals."[364] Another commentator argued specifically that, if the final rule causes owners to dispose of their

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[362] See, e.g., letters from AAEI; AngloGold; ArcelorMittal; Arkema; Cleary Gottlieb; CTIA; Davis Polk; Earthworks; Enough Project I; Enough Project IV; Global Tungsten I; Global Tungsten & Powders Corp. (Oct. 13, 2011) ("Global Tungsten II"); Howland; Industry Group Coalition I; ICAR et al. II; IPC I; IPMI I; ITIC I; ITRI I; ITRI Ltd. (Oct. 19, 2011) ("ITRI III"); ITRI Ltd. (Oct. 31, 2011) ("ITRI IV"); Japanese Trade Associations; Jean Goldschmidt International SA (Feb. 14, 2011) ("JGI"); JVC et al. II; Jewelers Vigilance Committee, American Gem Society, Manufacturing Jewelers & Suppliers of America, Jewelers of America, and Fashion Jewelry & Accessories Trade Association (Nov. 1, 2011) ("JVC et al. III"); Kemet; Kuala Lumpur Tin Market (Jan. 17, 2011) ("Kuala Tin"); LBMA I; Metal Solutions Corporation (Dec. 28, 2010) ("Solutions"); MSG III; NAM I; NEI; NMA II; NMA III; Pact II; PCP; Responsible Jewellery Council (Feb. 25, 2011) ("RJC I"); RMA; SEMI; Signet Jewelers Ltd. (Nov. 1, 2011) ("Signet"); Somima; TIAA-CREF; SIF I; and WGC II.

[363] Letter from ITRI I.

[364] Letter from Enough Project I.

existing conflict minerals inventory because they are unable to determine that they are "DCR conflict free," the cost of the rule would increase "dramatically."[365]

Panelists discussed this issue further at the SEC Roundtable. Some panelists explained that there are stocks of metals and other materials stored throughout the world in warehouses and vaults by many individuals and institutions that are already past the point in the supply chain at which they could contribute to conflict.[366] One panelist representing a human rights group appeared to acknowledge that stockpiled conflict minerals stored outside the Covered Countries would not contribute to conflict in the Covered Countries.[367] Another panelist asserted that a stockpile "exemption is essential for both existing unsmelted mineral and refined metal stocks held by industry, metal warehouses, investors and even in US Government stockpile," because the "value of current tin stocks is probably around US$7billion, generally with non-specific mine origin," so not exempting such minerals would lead to "market disruption and financial losses on this potentially unsaleable material."[368]

Many commentators suggested different requirements for when a conflict mineral should be considered stockpiled and, therefore, excluded from the final rule. A number of commentators recommended that the final rule should exempt any conflict minerals

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365 See letter from Claigan Environmental Inc. (Oct. 28, 2011) ("Claigan I").

366 See Transcript of SEC Roundtable on Conflict Minerals, Sections 0171-0174 (Oct. 18, 2011), available at http://www.sec.gov/spotlight/conflictminerals/conflictmineralsroundtable101811-transcript.txt.

367 See id. at Section 0172 lines 19-23 (stating that "there's a truth to the fact that if something is stockpiled out of the region, and it's being held somewhere else, does it really get at what the intent of the law is").

368 See id. at Section 0118 lines 8-15. See also letter from ITRI III.

mined prior to the adoption of the final rule.[369] One commentator noted, however, that "the date of extraction is not generally recorded or known for minerals purchased from artisanal miners."[370] Some commentators asserted that the final rule should exempt any conflict minerals smelted or refined by a certain date[371] because, as one of these commentators indicated, "[e]ach metal batch produced by a smelter will possess a dated certificate of analysis which may be considered as the production date."[372] Similarly, another commentator recommended that stockpiled gold that "has been fully refined before the effective date" of the final rule be exempted.[373] In this regard, one commentator suggested that the final rule exclude "inventory produced before the date on which Dodd-Frank 1502 will first apply to the issuer."[374] Another commentator "proposed that the effective date of disclosure requirement on metal should be for ingot produced [one] year after the effective date" of the final rule.[375]

A few commentators urged that the final rule exempt any conflict minerals outside the Covered Countries by July 15, 2010.[376] One commentator suggested that conflict minerals should be exempt if, by January 1, 2013, those minerals are included in components or products already incorporated in finished goods in a supplier's inventory

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369 See, e.g., letters from AAEI, Davis Polk, ITIC I, Kemet, MSG III, RJC I, RMA, and WGC II.

370 See letter from ITRI I.

371 See letters from ITRI I, LBMA I, and Signet.

372 See letter from ITRI I.

373 See letter from LBMA I.

374 See letter from ArcelorMittal.

375 See letter from ITRI III.

376 See letters from Earthworks and SIF I.

or are included in parts or components included in the repair or maintenance of products.[377] One commentator recommended that the final rule should exempt gold in the issuer's possession by, or extracted before, the effective date of the final rule.[378] Another commentator asserted that the final rule should exempt any conflict mineral that an issuer took possession of before the first full fiscal year following the adoption of the final rule.[379] This commentator suggested also that the final rule should not require reporting on conflict minerals in an issuer's supply chain that have been manufactured prior to the beginning of the issuer's first reporting year. One commentator asserted that the final rule should exclude, as of the date of the effectiveness of the final rule, "gold bars in storage at the central banks," "bars marked with the London Bullion Marketers Association (LBMA) stamp," and "gold coins issued by governments or other entities."[380] One commentator recommended that the final rule include a 24-month "grace period" that would permit the "sale of existing stockpiles of minerals that have already been mined and have been sitting in warehouses" in the DRC.[381]

c. **Final Rule**

After considering the comments, the final rule excludes any conflict minerals that

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377 See letter from NAM I.

378 See letter from AngloGold.

379 See letter from SEMI.

380 See letter from NMA III.

381 See letter from Charles F. Blakeman (Mar. 15, 2012) ("Blakeman III") (arguing overall that no final rule should be adopted, but seeking a 24-month grace period for the sale of existing stockpiles of conflict minerals, in the alternative, should the Commission adopt a final rule). See also letter from Charles Blakeman (Nov. 17, 2011) ("Blakeman II") (recommending a grace period for conflict minerals already, but not specifying a length of time for the grace period).

are "outside the supply chain" prior to January 31, 2013. The final rule considers conflict minerals to be "outside the supply chain" only in the following instances: after any columbite-tantalite, cassiterite, and wolframite minerals have been smelted; after gold has been fully refined; or after any conflict mineral, or its derivatives, that have not been smelted or fully refined are located outside of the Covered Countries.

We are aware that these existing stockpiles could have financed or benefited armed groups in the Covered Countries. However, once those minerals are smelted, refined, or outside of the Covered Countries, it appears unlikely that they could further finance or benefit armed groups. Therefore, applying the final rule to these already-stockpiled minerals would not further the purpose of the Conflict Minerals Statutory Provision because those minerals would not contribute to further conflict. Similarly, requiring issuers to determine the origin and chain of custody of these minerals that may have been extracted prior to the passage of the Conflict Minerals Statutory Provision, could result in undue costs if the minerals could not be sold, as suggested by one commentator.[382]

We considered exempting stockpiled conflict minerals that were extracted before a date certain, as one commentator recommended.[383] We decided not to do so, however, because, as another commentator noted, the date of extraction is not generally recorded or known for minerals from artisanal miners.[384] Further, if the final rule exempts conflict minerals extracted at a date certain, the rule would not necessarily account for payments

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[382] See letter from Claigan I.

[383] See letter from ITIC I.

[384] See letter from ITRI I.

illegally demanded by armed groups of those that transport conflict minerals through remote areas of the DRC. Instead, we believe that the proper point to use for ensuring that a conflict mineral is truly stockpiled is the smelting or primary refining date because the dates of these actions are more likely to be reliably recorded.[385] Similarly, as is true with smelted or refined conflict minerals, conflict minerals stockpiled outside the Covered Countries would not contribute to conflict in the Covered Countries.[386] Therefore, the final rule exempts any conflict minerals outside the Covered Countries as well.

We recognize that there may be situations in which conflict minerals are past the point in the supply chain where they are able to be used to finance or benefit armed groups, but these minerals have yet to be stored outside the Covered Countries,[387] smelted, or refined. Even so, we believe that smelting, refining, or being outside the Covered Countries marks the first opportunity in the supply chain that offers reliable proof that the conflict minerals will no longer benefit or finance armed groups. We note, however, that market participants may need additional time to move their stockpiles outside the Covered Countries or have those stockpiles smelted or refined. Therefore, to accommodate this timing constraint, the final rule provides transition relief to permit market participants sometime after the final rule becomes effective to move, smelt, or refine any existing stocks of conflict minerals without having to comply with the rule's

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[385] Id.

[386] See Transcript of SEC Roundtable on Conflict Minerals, at Section 0172 lines 19-23.

[387] For example, a stockpile of conflict minerals could be stored in a warehouse in a DRC country that is insulated from and is beyond the reach of any armed group, so these conflict minerals would not contribute to conflict.

requirements.

### 6. Timing of Implementation

#### a. Proposed Rules

The Conflict Minerals Statutory Provision states that issuers must disclose their conflict minerals information annually beginning with the issuer's first full fiscal year that begins after the date of promulgation of our final rule.[388] Therefore, the proposed rules would have included neither a transition period for issuers unable to determine that their conflict minerals did not originate in the Covered Countries or unable to determine that their conflict minerals that originated in the Covered Countries did not directly or indirectly finance or benefit armed groups, nor a general delay of the rules. We requested comment, however, regarding whether we should provide a transition period or a delay.

#### b. Comments on the Proposed Rules

In response to our request for comment, a number of commentators stated that the final rule should not permit any general delay or specific phase-in period for issuers to provide their conflict minerals information.[389] A number of other commentators, however, indicated that the final rule should allow for some type of delay or phase-in

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[388] Exchange Act Section 13(p)(1)(A).

[389] See, e.g., letters from Catholic Charities; Earthworks; Global Witness I; Good Shepherd; ICAR et al. II; Larry Cox of Amnesty International, Lisa Shannon of A Thousand Sisters, John Bradshaw of Enough Project, Karen Stauss of Free the Slaves, Corinna Gilfillan of Global Witness, Arvind Ganesan of Human Rights Watch, Tzivia Schwartz Getzug of Jewish World Watch, Morton Halperin of Open Society Policy Center, Rabbi David Saperstein of Religious Action Center of Reform Judaism, Kent Hill of World Vision (Mar. 1, 2011) ("Amnesty et al."); Rep. Berman et al.; Sen. Boxer et al. I; Senators Barbara Boxer, Frank R. Lautenberg, Barbara A. Mikulski, Sheldon Whitehouse and Ron Wyden (Feb. 16, 2012) ("Sen. Boxer et al. II"); Sen. Durbin / Rep. McDermott; Delly Mawazo Sesete (Dec. 19, 2011) ("Sesete"); State II; Synergie des Femmes Pour les Victimes des Violences Sexuelles (Mar. 7, 2011) ("Synergie"); World Vision US (Jul. 8, 2011) ("World Vision I"); and World Vision II.

period.[390] Some of the commentators specified that there should be a phase-in for only certain categories of issuers, such as foreign private issuers, accelerated filers, and smaller reporting companies.[391] Other commentators recommended that the final rule should include a phase-in period but did not provide any details for implementing such a mechanism.[392]

Some commentators asserted that the effectiveness of the final rule should be delayed for all issuers until either the Comptroller General has established auditing standards and/or the State Department has developed its conflict minerals map and its strategy to address linkages between human rights abuses and conflict minerals.[393] Other commentators stated that the final rule's effectiveness for all issuers should be delayed for two to five years after promulgation for issuers to set up traceability systems in the Covered Countries and clear mineral stockpiles from the supply chain.[394] One commentator stated that we should establish a general reporting delay for one year

[390] See, e.g., letters from AAEI; AAFA; AdvaMed I; AngloGold; Arkema; Barrick Gold; BEST II; Boeing Company (Oct. 18, 2011) ("Boeing"); Bureau d'Etudes Scientifiques et Techiques (Mar. 10, 2011) ("BEST I"); Chamber I; Corporate Secretaries I; CTIA; Davis Polk; Fédération des Enterprises du Congo (Feb. 25, 2011) ("FEC I"); Howland; Industry Group Coalition I; IPC I; ITIC I; ITRI I; ITRI II; ITRI IV; JGI; JVC et al. II; JVC et al. III; Medtronic, Inc. (Mar. 2, 2011) ("Medtronic"); Malaysia Smelting Corporation (Oct. 25, 2011) ("MSC II"); NAM I; National Association of Manufacturers (Jul. 26, 2011) ("NAM II"); NEI; NRF I; Pact I; PCP; Plexus (Feb. 25, 2011) ("Plexus"); Representative Mark S. Critz (Feb. 29, 2012) ("Rep. Critz"); RILA; RMA; Roundtable; Solutions; Somima; Taiwan Semi; TechAmerica, Professional Services Council, National Defense Industrial Association, American Council of Engineering Companies, Aerospace Industries Association, and U.S. Chamber of Commerce (Nov. 28, 2011) ("CODSIA"); TIC; TriQuint I; TriQuint Semiconductor Manufacturing Company, Ltd. (Mar. 2. 2011) ("TriQuint II"); and WGC II.

[391] See letters from AngloGold, Howland, and Taiwan Semi.

[392] See, e.g., letters from AAEI, AAFA, Arkema, BEST I, Chamber I, Davis Polk, FEC I, ITRI I, JGI, Medtronic, Solutions, MSC I, NEI, Pact I, Rep. Critz, and RMA.

[393] See letters from Barrick Gold, Corporate Secretaries I, NRF I, Roundtable, and WGC II.

[394] See, e.g., letters from AdvaMed I, Arkema, BEST II, FEC I, IPC I, ITRI I, ITRI II, ITRI IV, JVC et al. II, NAM I, Plexus, and TriQuint II.

following promulgation of the final rule to allow issuers the opportunity to eliminate conflict minerals from their products and, during this time, issuers would not be required to provide conflict minerals information.[395] Another commentator recommended a one-year general phase-in of the final rule "so that a thorough and reliable traceability process can be instituted."[396] In this regard, one commentator indicated that the "private sector is moving forward on this issue," and that one company "aims to have built the first verifiably conflict free microprocessor" by 2013.[397] Another commentator suggested that the final rule "set clear and specific dates for when company reporting will take effect," because "using benchmarks or trigger points will prolong the uncertainty that is causing so much trouble and suffering."[398]

A number of commentators recommended and described specific phase-in periods that focused on issuers unable to determine the origins of their conflict minerals.[399] Although each of these approaches varied to some degree, they all provided that, for a certain number of years after adoption of the final rule, an issuer unable to determine its conflict minerals' origins must disclose this fact, but would not be required to describe the products containing these conflict minerals as not "DRC conflict free." Some of

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395 See letter from PCP.

396 See also letter from Somima.

397 See letter from Senator Jeff Merkley and Representatives Peter DeFazio, Earl Blumenauer, Kurt Schrader, and Suzanne Bonamici (May 17, 2012) ("Sen. Merkley et al."). See also letter from Enough Project (Aug. 10, 2011) ("Enough Project III") (providing a link to an article that "details current efforts on the ground in response to Section 1502").

398 See letter from BEST II.

399 See, e.g., letters from AdvaMed I, CTIA, Industry Group Coalition I, IPC I, ITIC I, JVC et al. II, and NAM I.

these commentators recommended that we require an issuer, during a phase-in period, to describe its conflict minerals policy, its reasonable country of origin inquiry, the conflict minerals in its supply chains, and/or certain other information.[400] A few commentators indicated that we should phase-in the final rule for particular issuers based on the issuer's position in supply chain, so that an issuer closer in position to the mine or smelter would have to disclose more information regarding its conflict minerals.[401] One commentator recommended that the final rule permit a three-year phase-in period in which all issuers would be required only to receive certifications from their first-tier suppliers during the first year after promulgation, identify the smelters used to process their conflict minerals in the second year, and fully implement the rules in the third year.[402]

Many commentators, including industry associations, corporations, human rights groups, institutional investors, members of Congress, and individuals, agreed that all conflict minerals should be treated equally, as proposed.[403] Some commentators asserted that gold should be treated differently than the other three conflict minerals because of its unique qualities, and the OECD had not approved the supplement to its due diligence guidance specifically for gold,[404] which at the time of the Proposing Release was

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400 See letters from AdvaMed I, Industry Group Coalition I, and NAM I.

401 See letters from NRF I and Teggeman.

402 See letter from TriQuint II.

403 See, e.g., letters from Bario-Neal, Brilliant Earth, Calvert, Catholic Charities, CRS I, Earthworks, Enough Project I, Metalsmiths, Good Shepherd, Hacker Jewelers, Hoover & Strong, Howland, IPC I, ITRI I, NAM I, Niotan I, Peace, Rep. Berman et al., Sen. Durbin /Rep. McDermott, SIF I, State II, TakeBack, and TIAA-CREF.

404 See, e.g., letters from AngloGold, IPMI I, JVC et al. II, LBMA II, NMA II, Tiffany, TriQuint I, and WGC II.

scheduled to be published by the end of 2011. Subsequent commentators noted that the OECD's gold supplement would not be finalized until sometime in 2012,[405] and some commentators suggested that the final rule's application to gold be delayed until the OECD has adopted its gold supplement.[406] At present, the final gold supplement has been approved by the OECD.[407] One of the commentators suggested that the final rule be delayed for gold until the beginning of an issuer's first full fiscal year following adoption and issuance of the OECD's gold supplement.[408] Another one of the commentators argued that any "effort to establish credible and effective due diligence systems in the absence of OECD guidance will be stymied by the lack of a widely accepted base for responsible sourcing."[409] One commentator, however, asserted that the final rule should not be delayed for gold regardless of whether the OECD's gold supplement has been completed.[410] This commentator argued that, even if the OECD's gold supplement has not been completed when an issuer's reporting period begins, the issuer would still be able to apply the OECD's core due diligence framework to gold.

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[405] See letters from Government of Canada, Foreign Affairs and International Trade (Dec. 23, 2011) ("Canada"); JVC et al. III; Signet; World Gold Council, London Bullion Market Association, and Responsible Jewellery Council (Oct. 28, 2011) ("WGC et al. I"); and World Gold Council, London Bullion Market Association, and Responsible Jewellery Council (Dec. 9, 2011) ("WGC et al. II").

[406] See, e.g., letters from Boeing, JVC et al. III, Signet, World Gold Council (Jun. 20, 2011) ("WGC III"), WGC et al. I, and WGC et al. II.

[407] See OECD, DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS: SUPPLEMENT ON GOLD (2012), available at http://www.oecd.org/corporate/guidelinesformultinationalenterprises/FINAL%20Supplement%20on%20Gold.pdf.

[408] See letter from WGC et al. II.

[409] See letter from JVC et al. III.

[410] See letter from ICAR et al. II.

The commentators that advocated treating gold differently from the other conflict minerals comprise mostly gold, mining, and jewelry companies or associations. Of these commentators, only one indicated that the final rule should initially be more stringent with issuers using gold because 80% of the funds generated by conflict minerals for armed groups come from gold.[411] The other commentators indicated that the final rule should be more lenient for gold and that we should defer full incorporation of gold into the final rule because such a large percentage of gold coming from the DRC is illegally exported that it will require greater time and effort to make the gold supply chain transparent than it will for the other conflict minerals.[412] One commentator was concerned that, until a more transparent supply chain is developed, the final rule would stigmatize gold and thereby harm that mineral's ability to be used as a hedge and damage the global financial economy because so many companies would not be able to determine the origin of their gold.[413] Finally, a few commentators stated that the final rule should permit issuers to exclude certain information from public dissemination regarding the storage and transportation routes of gold for security reasons.[414]

### c. Final Rule

After considering the comments, the final rule will not provide a general delay of effectiveness, nor will the proposal be withdrawn and re-proposed. Although many commentators advocated that the final rule include an extended general delay of the

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[411] See letter from TriQuint I.

[412] See letters from AngloGold, IPMI I, JVC et al. II, NMA II, and WGC II.

[413] See letter from WGC II.

[414] See letters from NMA II, NAM III, and WGC II.

rule's effectiveness, we do not believe this approach would appropriately implement Congress's directive in the Conflict Minerals Statutory Provision. The provision states when an issuer must begin to report on its conflict minerals. Congress directed us to promulgate regulations requiring any "person described" to disclose annually, "beginning with the person's first full fiscal year that begins after the date of promulgation of such regulations."[415] Additionally, it is not clear that a general delay of the final rule is necessary or appropriate. As noted by two of the co-sponsors of the statutory provision, conflict minerals legislation was first considered in 2008, the Conflict Minerals Statutory Provision was over a year old at the time of the letter, and many issuers have been working with various groups in developing supply chain tracing for years.[416] Therefore, under the final rule, most issuers with necessary conflict minerals will be required to file a specialized disclosure report on or before May 31, 2014 containing conflict minerals disclosure for the initial reporting period that will extend from January 1, 2013 to December 31, 2013.

Since Congress adopted the Conflict Minerals Statutory Provision in July 2010, we have sought comment on our implementation of the provision, including our proposal, and have provided opportunities for commentators to provide their input, both before and after the rules were proposed. As noted above, we extended the comment period for the rule proposal and convened an October 2011 roundtable at the request of commentators. We have continued to receive comment letters through August 2012, all of which we

415 See Exchange Act Section 13(p)(1)(A).

416 See letter from Sen. Durbin / Rep. McDermott.

have considered. Some commentators have provided responses to other commentators, particularly on the Economic Analysis. This robust, public, and interactive debate has allowed us to more fully consider how to develop our final rule. Additionally, as discussed further in the Economic Analysis section, below, we have considered and analyzed the numerous comments received regarding the costs and complexities of the statute and proposed rule, and have taken them into account in the final rule. Overall, we believe interested parties have had sufficent opportunity to review the proposed rules, as well as the comment letters, and to provide views on the proposal, other comment letters, including data to inform our consideration of the final rule. Accordingly, we do not believe that withdrawal of the proposed rule and re-proposal is necessary.

While the final rule does not include a general delay for the reasons noted, we acknowledge that there are legitimate concerns about the feasibility of preparing the required disclosure in the near term because of the stage of development of the supply chain tracing mechanisms. In order to address these concerns, rather than providing an extended general delay of effectiveness, the final rule includes a targeted and temporary provision intended to help issuers address some of the burdens and costs of compliance with the final rule. For all issuers, this period will last two years, including issuers' 2013 and 2014 reporting periods, but will not be permitted for the reporting period beginning January 1, 2015. For smaller reporting companies, this period will last four years, including issuers' 2013 through 2016 reporting periods, but will not be permitted for the reporting period beginning January 1, 2017. We note that, although some commentators recommended that there be no such transition period and other commentators recommended that such a transition period be permitted for either a shorter or longer amount of time, a number of commentators appeared to suggest that a transition period through 2014 would be appropriate to allow the necessary traceability systems in the Covered Countries to be established.[417] Issuers taking advantage of this temporary category are still be required to conduct due diligence and prepare and file a Conflict Minerals Report, and are required to disclose in their Conflict Mineral Report all steps taken by such issuer, if any, since the issuer's last such report to mitigate the risk that its necessary conflict minerals benefit armed groups, including any steps to improve its due diligence.

As discussed in greater detail below, the final rule provides a temporary "DRC conflict undeterminable" category for a two-year period for all issuers and a four-year period for smaller reporting companies. This category is available for issuers that proceed to step three but are unable to determine, after exercising their required due diligence,[418] whether their conflict minerals originated in the Covered Countries or

[417] See, e.g., letters from AdvaMed I (recommending an "unknown determination" transition period at least through 2014), FEC I ("Disclosure of minerals mined could be mainly conflict free for 2014 and finally the companies could successfully report to the Securities and Exchange Commission in 2015."), JVC et al. II (urging "the Commission to adopt a calibrated 'phase-in' disclosure approach spanning the period from April 15, 2011 (the statutorily-prescribed effective date of the Commission's implementing rules) through at least early 2014, to afford all affected issuers a minimum two-year transition period before becoming obligated to furnish an audited CMR"), Plexus (suggesting that a "phase in compliance schedule of at least 2 years is needed in order to provide time for the due diligence systems to be set-up, most importantly on the ground in the DRC," but even "this would be a significant challenge"), Verizon (recommending "delaying the full applicability of the due diligence requirements of the Conflict Minerals Report until after fiscal 2014, to allow the DRC Zone countries to develop the traceability protocols and related infrastructure required in order to supply Conflict Free Smelters"), and WilmerHale ("After fiscal year 2014, when sufficient infrastructure is expected to have been developed to permit companies to determine the source of all their conflict minerals, the 'indeterminate source' category would no longer be available.").

[418] As discussed in greater detail below, issuers are required to exercise due diligence on the source and chain of custody of their conflict minerals and potentially provide a Conflict Minerals Report if, following their reasonable country of origin inquiry, they know they have conflict minerals from the Covered Countries and not from recycled or scrap sources, or they have reason to believe that their conflict minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources. Only after these issuers have exercised their required due diligence may they use the "DRC conflict

whether their conflict minerals that originated in the Covered Countries directly or indirectly finance or benefit armed groups in the Covered Countries.

The final rule permits any such issuer for purposes of the conflict minerals disclosure to describe its products with such conflict minerals as "DRC conflict undeterminable," unless those products also include other conflict minerals that directly or indirectly financed or benefited armed groups in the Covered Countries. Further, although issuers with "DRC conflict undeterminable" products are required to provide a Conflict Minerals Report that describes, among other matters, the measures taken by the issuer to exercise due diligence on the source and chain of custody of the conflict minerals, during the temporary period they will not have to provide an independent private sector audit of that report. We believe that not requiring an independent private sector audit of the Conflict Minerals Report during the temporary period is appropriate because an audit of the design of an issuer's due diligence that results in an undeterminable conclusion would not appear to have a meaningful incremental benefit.

### D. Step Two – Determining Whether Conflict Minerals Originated in the Democratic Republic of the Congo or Adjoining Countries and the Resulting Disclosure

Once an issuer determines that conflict minerals are necessary to the functionality or production of a product manufactured or contracted to be manufactured by the issuer, the Conflict Minerals Statutory Provision requires the issuer to determine whether those

undeterminable" alternative if they are still unable to determine that their conflict minerals originated in the Covered Countries or, if they determine that their minerals did originate in the Covered Countries, but they are unable to determine that their conflict minerals directly or indirectly financed or benefited armed groups in the Covered Countries.

conflict minerals originated in the Covered Countries.[419] If so, the issuer must submit a Conflict Minerals Report concerning those conflict minerals that originated in the Covered Countries,[420] and make that report available on its Internet website.[421] To determine whether their conflict minerals originated in the Covered Countries, so as to determine whether they must exercise due diligence on the source and chain of custody of those minerals and provide a Conflict Minerals Report, the final rule requires issuers with necessary conflict minerals to conduct a reasonable country of origin inquiry.

### 1. Reasonable Country of Origin Inquiry

#### a. Proposed Rules

We proposed that an issuer would be required to disclose whether it has necessary conflict minerals that originated in the Covered Countries based on its "reasonable country of origin inquiry." Our proposed rules did not specify, however, what constituted a reasonable country of origin inquiry. Rather than describing what a reasonable country of origin inquiry would entail, we indicated that such a determination would depend on each issuer's particular facts and circumstances. In this regard, we noted that the reasonable country of origin inquiry requirement was not meant to suggest that issuers would have to determine with absolute certainty whether their conflict minerals originated in the Covered Countries as we have often stated that a reasonableness

[419] See Exchange Act Section 13(p)(1)(A).

[420] See id.

[421] See Exchange Act Section 13(p)(1)(D).

standard is not the same as an absolute standard.[422]

### b. Comments on the Proposed Rules

One commentator indicated that the final rule should not include a reasonable country of origin inquiry for determining whether an issuer's conflict minerals originated in the Covered Countries.[423] This commentator objected to the use of a reasonable country of origin inquiry because it believed that the origin of a product should be determined based on where the product is produced rather than where the minerals in the product were mined. Another commentator recommended that the final rule not require issuers to make any reasonable country of origin inquiry at all if they determine, based on whatever means they believe appropriate, that their conflict minerals did not originate in the Covered Countries, provided they disclose this fact.[424] Many other commentators on this subject agreed that the proposed rules' reasonable country of origin inquiry approach is appropriate.[425] Some of these commentators disagreed, however, on the meaning and

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[422] Cf. Foreign Corrupt Practices Act (the "FCPA"), 15 U.S.C. 78m(b)(7) and Exchange Act Section 13(b)(7), which states that "the terms 'reasonable assurances' and 'reasonable detail' mean such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs." The release further cites to the conference committee report on amendments to the FCPA, CONG. REC. H2116 (daily ed. Apr. 20, 1988), which states the reasonableness "standard 'does not connote an unrealistic degree of exactitude or precision,'" but instead "'contemplates the weighing of a number of relevant factors, including the cost of compliance.'"

[423] See letter from Teggeman.

[424] See letter from Roundtable (stating that the "Conflict Minerals Statutory Provision requires issuers to disclose 'whether' their conflict minerals originated in the Covered Countries, and, in the case of a positive determination, to provide a Conflict Minerals Report," and it "does not impose any obligation on an issuer who determines that the conflict minerals did not originate in the Covered Countries to make any disclosure beyond that fact, nor does it specify how the issuer is to determine that the conflict minerals did not originate in the Covered Countries").

[425] See, e.g., letters from AAFA, AngloGold, ArcelorMittal, Barrick Gold, Boeing, Chamber I, Cleary Gottlieb, CRS I, Enough Project I, Evangelical Alliance, Evangelicals, Global Witness I, Howland, ICGLR, Industry Group Coalition I, IPC I, IPMI I, ITIC I, JVC et al. II, LBMA I, Metalsmiths, Methodist Board,

application of the standard. Some such commentators asserted that a reasonable country of origin standard should be equivalent to the due diligence standard required for the Conflict Minerals Report.[426] Others suggested that the reasonable country of origin standard should conform, at least in part, to international standards,[427] such as the "preliminary review" in the OECD guidance.[428]

Many commentators agreed that the final rule should not define the reasonable country of origin standard, or should provide only general guidance regarding the standard, so that the rules would allow for greater flexibility to evolve as processes improved.[429] Some of these commentators provided examples of the general guidance that the final rule could include while still allowing flexibility.[430] For example, some commentators suggested that we indicate that the reasonable country of origin inquiry could differ among issuers based on their size, products, and relationships with

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MSG I, NAM I, NEI, NMA II, NYCBar I, NYCBar II, RILA-CERC, SEMI, Semiconductor, SIF I, SIF II, PCP, Presbyterian Church II, Sen. Durbin / Rep. McDermott, State II, TIAA-CREF, TIC, TriQuint I, and WGC II.

426 See letters from Metalsmiths and Sen. Durbin / Rep. McDermott.

427 See letters from CRS I and IPMI I.

428 See letter from IPMI I (stating that "the OECD advocates an initial determination of origin inquiry"). See also OECD, OECD DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS, 33 (2011), available at http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/46740847.pdf. ("This Guidance applies to actors operating in a conflict-affected and high-risk area, or potentially supplying or using tin (cassiterite), tantalum (tantalite) or tungsten (wolframite), or their smelted derivates, from a conflict-affected and high-risk area. Companies should preliminarily review their mineral or metal sourcing practices to determine if the Guidance applies to them.").

429 See, e.g., letters from AAFA, AngloGold, ArcelorMittal, Industry Group Coalition I, IPC I, IPMI I, ITIC I, JVC et al. II, NAM I, RILA-CERC, Semiconductor, SIF I, TriQuint I, and WGC II.

430 See, e.g., letters from Industry Group Coalition I, IPC I, ITIC I, NAM I, RILA-CERC, and SIF I.

suppliers.[431] In addition, one commentator recommended that the final rule should clarify that a "reasonable person" standard applies to the reasonable country of origin standard.[432] As a further example, some commentators sought flexibility for the reasonable country of origin standard that permits some combination of reasonable supplier declarations, contractual obligations, risk-based follow-up, and/or smelter validations.[433] One commentator asserted that an issuer's reasonable country of origin inquiry should be conducted under a reasonable care standard that requires "more than a passive acceptance by the filer of information provided by their suppliers," which does not "mandate that an issuer always reach the legally correct conclusion, but does require sufficient investigation by an issuer to support reasonable cause to believe in the conclusion."[434]

Some commentators asserted that the final rule should define or provide specific guidance on what constitutes a "reasonable country of origin inquiry," although many of these commentators did not provide suggested definitions or guidance.[435] A few commentators argued, however, that any definition or guidance in the final rule should make clear that a reasonable country of origin standard should not be an absolute

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[431] See letters from IPC I and ITIC I.

[432] See letter from RILA-CERC.

[433] See, e.g., letters from Industry Group Coalition I and NAM I.

[434] See letter from Enough Project IV.

[435] See, e.g., letters from CRS I, Earthworks, Enough Project I, Evangelical Alliance, Evangelicals, Global Witness I, Howland, ICGLR, IPC I, IPMI I, Metalsmiths, Methodist Board, MSG I, NYCBar I, NYCBar II, PCP, Presbyterian Church II, Roundtable, SEMI, Sen. Durbin / Rep. McDermott, State II, and TIC.

standard.[436] One commentator suggested that the reasonable country of origin inquiry standard should require an issuer to take "sufficient steps to accurately determine and disclose whether its conflict minerals originate from the DRC," and the commentator, therefore, recommended that an issuer should disclose the steps it undertook to complete its inquiry.[437]

A large number of commentators suggested that, as part of a reasonable country of origin standard, the final rule should permit an issuer to rely on reasonable representations from suppliers and/or smelters.[438] Other commentators recommended, however, that written representations could provide only some evidence in making a reasonable country of origin inquiry but should not, by themselves, satisfy the reasonable country of origin inquiry standard.[439] Some of these commentators provided examples of other evidence an issuer could use in addition to written representations in satisfying a reasonable country of origin standard, including contractually obligating suppliers to source only from conflict-free smelters, conducting spot checks of suppliers and smelters to verify they are obtaining conflict minerals from only conflict-free sources, disclosing publicly the smelters used and the processes undertaken to ensure that only conflict-free minerals are used, and/or determining that there is no contrary evidence or "red flags"

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[436] See letters from Chamber I, Cleary Gottlieb, and NAM I.

[437] See letter from SIF II.

[438] See, e.g., letters from AngloGold, Arkema, Cleary Gottlieb, Global Tungsten I, Global Tungsten II, Howland, ICGLR, IPC I, IPC II, NAM I, NEI, NMA II, PCP, RILA, Roundtable, SEMI, Taiwan Semi, TIAA-CREF, TIC, TriQuint I, US Telecom, and WGC II.

[439] See, e.g., letters from CTIA, Enough Project I, Global Witness I, Howland, IPMI I, ITIC I, MSG I, NYCBar II, Sen. Durbin / Rep. McDermott, SIF I, and TIC.

that would cast doubt on the minerals' origins.[440] Some commentators suggested that an issuer should be able to rely on representations from smelters only if the smelter was designated "compliant" by nationally or internationally recognized standards.[441] A few commentators, however, asserted that smelters and refiners are unable to verify the country of origin of the minerals they process at the present time.[442] One commentator argued that an issuer should be able to rely on reasonable representations "one or two steps up the supply chain," but that these representations should be made public.[443]

Commentators were almost evenly split about whether the final rule should allow an issuer to use qualifying or explanatory language in concluding whether its conflict minerals originated in the Covered Countries.[444] Some of the commentators that believed the final rule should permit some qualification or explanation, however, qualified their recommendations.[445]

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[440] See, e.g., letters from Enough Project I, Global Witness I, IPMI I, and MSG I.

[441] See letters from Howland, Enough Project I, ITIC I, MJB Consulting (May 30, 2011) ("MJB III"), MSG III, NYCBar II, SIF I, and TIC.

[442] See letters from Nordic Sun Worldwide Ltd. (Mar. 17, 2012) ("Nordic Sun") (stating that, before smelter verification schemes can be relied upon, "a more scientific component must be added," and that only "the addition of a low acquisition cost mineral analyzer with a reasonably detailed geologic mineralization fingerprinting capability that include GPS location data and certification tag data in a tamper-proof format will add the necessary missing step to all the 3T minerals and smelter certification systems") and Southern Africa Resource Watch (Apr. 4, 2012) ("SARW") (stating that any scheme that "essentially depends on assurances from refining and smelting facilities will not be helpful"). But see letter from iTSCi Programme Governance Committee (Apr. 14, 2012) ("iTSCi") (refuting the letter from Nordic Sun).

[443] See letter from Hileman Consulting.

[444] Some commentators asserted that such language should be permitted. See letters from AngloGold, Cleary Gottlieb, Howland, NAM I, NMA II, and WGC II. Others took the opposite view. See letters from CRS I, Earthworks, Global Witness I, NEI, and State II.

[445] See letters from Howland (stating that an issuer should be able to use qualifying language only if it knows that 80% or more of its conflict minerals did not originate from the Covered Countries), MSG I (stating that qualifying language is not relevant as long as an issuer discloses the manner in which it

c. Final Rule

After considering the comments, we are adopting the final rule regarding the reasonable country of origin inquiry substantially as proposed, but with some modification. The final rule does not specify what steps and outcomes are necessary to satisfy the reasonable country of origin inquiry requirement because, as stated in the Proposing Release, such a determination depends on each issuer's particular facts and circumstances. A reasonable country of origin inquiry can differ among issuers based on the issuer's size, products, relationships with suppliers, or other factors.[446] Further, as we stated in the Proposing Release, we continue to believe that the steps necessary to constitute a reasonable country of origin inquiry depend on the available infrastructure at a given time. As commentators noted, such an approach allows the final rule to be flexible and evolve with available tracing processes.

Even though the final rule does not specify the steps necessary to satisfy the reasonable country of origin inquiry requirement, the final rule includes general standards governing the inquiry and the steps required as a result of the inquiry. First, the final rule provides that, to satisfy the reasonable country of origin inquiry requirement, an issuer's reasonable country of origin inquiry must be reasonably designed to determine whether

determined its reasonable country of origin inquiry), NAM I (stating that qualifying language should be permitted only when there is appropriate information to support the conclusion), NMA II (same), and TriQuint I (stating that the final rule should allow qualifying language when an issuer concludes that its conflict minerals are not "DRC conflict free," but should not allow such a qualification if it states that its conflict minerals are, in fact, "DRC conflict free").

[446] As we indicated in the Proposing Release, although a reasonable country of origin inquiry may be based on a particular issuer's size, products, relationships with suppliers, or another factor, an issuer may not conclude that, because of the large (or small) amount of conflict minerals it uses in its products or the large (or small) number of products that include conflict minerals, it is unreasonable for that issuer to conduct any inquiry into the origin of its conflict minerals. Instead, that issuer must make some inquiry into the origin of its conflict minerals.

the issuer's conflict minerals did originate in the Covered Countries, or did come from recycled or scrap sources, and it must be performed in good faith. The proposed rules did not discuss the design of an issuer's reasonable country of origin inquiry or an issuer's performance in carrying out its reasonable country of origin inquiry. We believe providing these standards in the rule will facilitate compliance with the rule by providing guidance to issuers about what is required to satisfy the reasonable country of origin inquiry. In this regard, we note that one commentator stated that "[i]t is **essential**, in order to make the implementation of 1502 practical and cost effective, that the concept of reasonableness, and good faith efforts" be recognized in the final rule.[447] Further, we believe the notion of good faith performance is important so that an issuer will not be able to establish a reasonably designed inquiry but subsequently fail to undertake the steps necessary to carry out the actual inquiry.

Although we do not prescribe the steps constituting a reasonable country of origin inquiry, we do view an issuer as satisfying the reasonable country of origin inquiry standard if it seeks and obtains reasonably reliable representations indicating the facility at which its conflict minerals were processed and demonstrating that those conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources. These representations could come either directly from that facility or indirectly through the issuer's immediate suppliers, but the issuer must have a reason to believe these representations are true given the facts and circumstances surrounding those representations. An issuer must also take into account any applicable warning signs or

[447] See letter from ITRI IV (emphasis in original).

other circumstances indicating that its conflict minerals may have originated in the Covered Countries or did not come from recycled or scrap sources.[448] An issuer would have reason to believe representations were true if a processing facility received a "conflict-free" designation by a recognized industry group that requires an independent private sector audit of the smelter, or an individual processing facility, while it may not be part of the industry group's "conflict-free" designation process, obtained an independent private sector audit that is made publicly available. An issuer's policies with respect to the sourcing of conflict minerals will generally form a part of the issuer's reasonable country of origin inquiry, and therefore would generally be required to be disclosed in the issuer's Form SD.

Moreover, the issuer is not required to receive representations from all of its suppliers. The standard focuses on reasonable design and good faith inquiry. Therefore, if an issuer reasonably designs an inquiry and performs the inquiry in good faith, and in doing so receives representations indicating that its conflict minerals did not originate in the Covered Countries, the issuer may conclude that its conflict minerals did not originate in the Covered Countries, even though it does not hear from all of its suppliers, as long as it does not ignore warning signs or other circumstances indicating that the remaining

[448] As discussed below, this approach is consistent with the OECD's due diligence guidance, which states that issuers should preliminarily review their sourcing practices to determine if their due diligence guidance applies, and provides non-exclusive examples of situations that it states should trigger the guidance. See OECD, OECD DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS (2011), available at http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/46740847.pdf. See also OECD, DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS: SUPPLEMENT ON GOLD (2012), available at http://www.oecd.org/corporate/guidelinesformultinationalenterprises/FINAL%20Supplement%20on%20Gold.pdf.

amount of its conflict minerals originated or may have originated in the Covered Countries. For example, we would agree that, "if reasonable inquiry has been made, and if no evidence of [Covered Country] origin has arisen, and if the origin of only a small amount of gold were still unknown, a manufacturer should be allowed to declare that its gold is not from the [Covered Countries] and is DRC conflict free."[449]

The reasonable country of origin inquiry is consistent with the supplier engagement approach in the OECD guidance where issuers use a range of tools and methods to engage with their suppliers.[450] The results of the inquiry may or may not trigger due diligence. This is the first step issuers take under the OECD guidance to determine if the further work outlined in the OECD guidance – due diligence – is necessary. The Conflict Minerals Statutory Provision specifically contemplates due diligence, which goes beyond inquiry and involves further steps to establish the truth or accuracy of relevant information, by requiring a description of the measures the issuer took to exercise due diligence on the source and chain of custody of the minerals. The Conflict Minerals Statutory Provision specifically notes that due diligence includes the audit discussed below.

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[449] See letter from IPMI I. Commentators opining on whether the statutory language requiring due diligence and a Conflict Minerals Report applies only to issuers that know that their conflict minerals originated in the Covered Countries or whether that statutory language applies also to issuers that are unable to determine that their conflict minerals did not originate in the Covered Countries did not necessarily discuss this topic in relation to conflict minerals from recycled or scrap sources.

[450] In June 2012, the OECD issued a report regarding implementation of the OECD guidance. See OECD, DOWNSTREAM IMPLEMENTATION OF THE OECD DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS, CYCLE 2 INTERIM PROGRESS REPORT ON THE SUPPLEMENT ON TIN, TANTALUM, AND TUNGSTEN FINAL DRAFT (June 2012), available at http://www.oecd.org/investment/guidelinesformultinationalenterprises/Downstream%20cycle%202%20report%20-%20Edited%20Final%20-%201%20June.pdf. This additional guidance includes sample letters to suppliers and customers regarding the use of conflict minerals.

Second, the final rule establishes a different standard from that included in the proposal for determining whether due diligence on the conflict minerals' source and chain of custody and a Conflict Minerals Report is required after the reasonable country of origin inquiry. The proposed rules would have required an issuer to conduct due diligence and provide a Conflict Minerals Report if, based on its reasonable country of origin inquiry, the issuer determined that its conflict minerals originated in the Covered Countries, the issuer was unable to determine that its conflict minerals did not originate in the Covered Countries, or the issuer determined that its conflict minerals came from recycled or scrap sources. Under the proposal, issuers could only avoid providing a Conflict Minerals Report if they could prove a negative – that their conflict minerals did not originate in the Covered Countries. This approach would arguably be more burdensome than necessary to accomplish the purpose of the statutory provision. The reasonable country of origin inquiry standard does not require an issuer to determine to a certainty that all its conflict minerals did not originate in the Covered Countries because the standard required is a reasonable inquiry, and requiring a certainty in this setting would not be reasonable and may impose undue costs.[451]

Under the final rule, if (i) an issuer determines that, based on its reasonable country of origin inquiry, its necessary conflict minerals did not originate in the Covered Countries or did come from recycled or scrap sources, or (ii) based on its reasonable country of origin inquiry, the issuer has no reason to believe that its conflict minerals may have originated in the Covered Countries or the issuer reasonably believes that its conflict

[451] As discussed below, certainty also is not required for the due diligence inquiry.

minerals are from recycled or scrap sources, the issuer is not required to exercise due diligence on its conflict minerals' source or chain of custody or file a Conflict Minerals Report with respect to such conflict minerals. Instead, the issuer only is required, in the body of its specialized disclosure report, to disclose its determination and briefly describe the reasonable country of origin inquiry it undertook in making its determination and the results of the inquiry it performed.

Conversely, an issuer must exercise due diligence on its conflict minerals' source and chain of custody and provide a Conflict Minerals Report if the issuer knows that it has necessary conflict minerals that originated in the Covered Countries and did not come from recycled or scrap sources. In addition, if, based on its reasonable country of origin inquiry, the issuer has reason to believe that its necessary conflict minerals may have originated in the Covered Countries (and may not have come from recycled or scrap sources), the issuer must also exercise due diligence on the source and chain of custody of its conflict minerals. If, however, as a result of that due diligence, such an issuer determines that its conflict minerals did <u>not</u> originate in the Covered Countries or that its conflict minerals <u>did</u> come from recycled or scrap sources, no Conflict Minerals Report is required, but the issuer is required, in the body of its specialized disclosure report, to disclose its determination and briefly describe its due diligence and the results of the due diligence. If, based on its due diligence, the issuer determines that its conflict minerals did originate in the Covered Countries, and did not come from recycled or scrap sources, the issuer is required to submit a Conflict Minerals Report. If, based on its due diligence, the issue cannot determine the source of its conflict minerals, it is also required to submit a Conflict Minerals Report.

This revised approach does not require an issuer to prove a negative to avoid moving to step three, but it also does not allow an issuer to ignore or be willfully blind to warning signs or other circumstances indicating that its conflict minerals may have originated in the Covered Countries. This approach appears consistent with the "reason-to-believe approach" provided by one commentator.[452] Also, as some commentators noted,[453] this approach is consistent with the OECD's due diligence guidance, which states that issuers "should preliminarily review their mineral or metal sourcing practices to determine if the [due diligence] Guidance applies to them."[454] In its due diligence guidance, the OECD provides non-exclusive examples of circumstances, or red flags, that it states should trigger its guidance.[455] One example of a circumstance that, absent other

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[452] See letter from Tiffany ("A better way to address this issue would be to impose the obligation to submit a conflict minerals report on only those companies that actually have a reason to believe that they use gold (or some other 'conflict mineral') that does, in fact, originate in the DRC or surrounding countries (the 'reason-to-believe approach').").

[453] See letters from Enough Project I (stating that, through its reasonable country of origin inquiry, "an issuer should identify red flags that would alert it to the possibility that the minerals in its products support conflict in the DRC and adjoining countries," and citing to the OECD's due diligence guidance), Global Witness I (stating that an issuer should "[r]eview for and consider 'red flags' indicating possible sourcing from Covered Countries," and citing to the OECD's due diligence guidance), and IPMI I ("The OECD's new international standard for an initial inquiry is a specific point where harmonization will be particularly advantageous, while conforming well to the direction of Congress for a reasonable country of origin inquiry. Like Congress, the OECD advocates an initial determination of origin inquiry: 'Companies should preliminarily review their mineral or metal sourcing practices to determine if the Guidance applies to them.'").

[454] See OECD, OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, 33 (2011), available at http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/46740847.pdf.

[455] See id. (providing a number of examples, including whether conflict minerals are claimed to originate from a country that has limited known reserves of the conflict mineral in question) and OECD, Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: Supplement on Gold (2012), available at http://www.oecd.org/corporate/guidelinesformultinationalenterprises/FINAL%20Supplement%20on%20Gold.pdf. The gold supplement also addresses circumstances triggering due diligence for gold claimed to have come from recycled or scrap sources.

information, should provide an issuer with reason to believe that its conflict minerals may have originated in the Covered Countries is if an issuer becomes aware that some of its conflict minerals were processed by smelters that sourced from many countries, including the Covered Countries, but the issuer is unable to determine whether the particular minerals it received from such a "mixed smelter" were from the Covered Countries.[456]

We appreciate that commentators differ in their views as to when due diligence and, potentially, a Conflict Minerals Report is required under the language of the Conflict Minerals Statutory Provision. The provision requires issuers to provide a Conflict Minerals Report if their conflict minerals "did originate" in the Covered Countries but does not address how to determine whether the minerals "did originate" in those countries.[457] The final rule adopts the reasonable country of origin inquiry as the procedure for making this determination. Some commentators argued that the statutory language should be read to require that only an issuer that knows, after conducting its reasonable country of origin inquiry, that its conflict minerals originated in the Covered Countries must perform due diligence and provide a Conflict Minerals Report.[458] Alternatively, other commentators argued that the provision should be read to require issuers that are unable to determine that their conflict minerals did not originate in the

[456] This scenario is consistent with the OECD due diligence framework's statement that "tracing minerals in a company's possession are generally unfeasible after smelting, with refined metals entering the consumer market as small parts of various components in end products." See OECD, OECD DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS, 33 (2011), available at http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/46740847.pdf.

[457] See Exchange Act Section 13(p)(1)(A) (stating that "in cases in which such conflict minerals did originate in the" Covered Countries (emphasis added), the issuer must "submit to the Commission" a Conflict Minerals Report).

[458] See, e.g., letters from AngloGold, Clearly Gottlieb, NAM I, and Tiffany.

Covered Countries to perform due diligence and potentially submit a Conflict Minerals Report.[459] We believe the approach that is most consistent with the statutory language and its purposes, however, is to require any issuer that, after the reasonable country of origin inquiry, knows that its minerals originated in the Covered Countries and did not come from recycled or scrap sources to perform due diligence regarding those minerals and submit a Conflict Minerals Report. In addition, any issuer that, after conducting its reasonable country of origin inquiry, has reason to believe that its minerals may have originated in the Covered Countries, and may not have come from recycled or scrap sources must perform due diligence. If, as a result of that due diligence, such an issuer determines that its conflict minerals did not originate in the Covered Countries or did come from recycled or scrap sources, no Conflict Minerals Report is required (although, as discussed below, such due diligence, and the results thereof, must be disclosed in the body of such issuer's specialized disclosure report, together with the description of such issuer's reasonable country of origin inquiry). Otherwise, such an issuer must submit a Conflict Minerals Report. We are adopting this approach in the final rule.

Interpreting the Conflict Minerals Statutory Provision to require due diligence only if an issuer has affirmatively determined that its conflict minerals originated in the Covered Countries and does not come from recycled or scrap sources would undermine the goals of the statute. For instance, if we allowed an issuer to stop its inquiry after learning that its necessary conflict minerals came from a smelter that includes minerals from the Covered Countries and other sources without knowing if its particular minerals

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459 See, e.g., letters from NEI, NYCBar I, and NYCBar II.

came from the Covered Countries, there would be an incentive for issuers to avoid learning the ultimate source of the minerals. Thus, although we realize our approach will be more costly than only requiring due diligence and, potentially, a Conflict Minerals Report if the issuer has affirmative knowledge that its minerals came from the Covered Countries, in our view, requiring further steps by issuers that have reason to believe that they have necessary conflict minerals that may have originated in the Covered Countries is necessary to carry out the requirements contemplated by the statute. Moreover, this approach strikes a more appropriate balance than requiring an issuer to prove a negative – that their necessary conflict minerals did not originate in the Covered Countries – which would be even more costly.

Alternatively, the Conflict Minerals Statutory Provision could be interpreted to require all issuers to determine whether their conflict minerals originated in the Covered Countries through the exercise of due diligence. This inquiry could be quite costly, especially in a situation in which an issuer is unable to determine that a very small amount of its overall conflict minerals did not originate in the Covered Countries or come from recycled or scrap sources. While such an interpretation of the provision is plausible and, in fact, was suggested by two of the co-sponsors of the provision as the accurate interpretation of the Conflict Minerals Statutory Provision,[460] we do not believe that approach is necessary to achieve Congress's goal. Instead, we believe the reasonable country of origin inquiry standard provides a clearer way for issuers to make the

[460] See letter from Sen. Durbin / Rep. McDermott ("The proposed rule differentiates between the country of origin inquiry and the due diligence involved in determining the source and chain of custody of conflict minerals, indicating that the former could be 'less exhaustive.' This is a misreading of our intent – we see no difference in the effort that should be exercised in each case.").

necessary determination and does so in a manner that significantly reduces burdens and is more cost-effective. Although the reasonable country of origin inquiry will impose costs on issuers, we believe the costs are lower than those that would be incurred if issuers were always required to perform due diligence.

Finally, we note that an issuer conducting an appropriate reasonable country of origin inquiry may not be able to determine to a certainty the origin of all its conflict minerals or whether they came from recycled or scrap sources. A certainty is not required to satisfy the reasonable country of origin inquiry standard. Disclosure indicating that the determination is uncertain is unnecessary. Consistent with this approach, issuers may explicitly state that, if true, their reasonable country of origin inquiry was reasonably designed to determine whether the conflict minerals did originate in the Covered Countries or did not come from recycled or scrap sources and was performed in good faith, and the issuer's conclusion that the conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources was made at that reasonableness level.

**2. Disclosures in the Body of the Specialized Disclosure Report**

**a. Proposed Rules**

Under the proposed rules, an issuer would have been required to make a reasonable country of origin inquiry as to whether its conflict minerals originated in the Covered Countries. After the reasonable country of origin inquiry, if an issuer concluded that its conflict minerals did not originate in the Covered Countries, the issuer would have been required to disclose its conclusion in the body of its annual report and on its

Internet website.[461] Also, the proposed rules would have required that such an issuer disclose in the body of its annual report and on its Internet website the reasonable country of origin inquiry it used in making that determination. The proposed rules would not, however, have required an issuer that, after its reasonable country of origin inquiry, determined that its conflict minerals did not originate in the Covered Countries to disclose the actual countries from which the conflict minerals originated. The issuer would have been required to provide in the body of the annual report the Internet address on which the disclosure was posted and retain the information on the website at least until the issuer's subsequent annual report was filed. Finally, the issuer would have been required to maintain reviewable business records in support of its negative determination. The issuer, however, would not have been required to make any other disclosures with regard to the conflict minerals that did not originate in the Covered Countries.

Alternatively, if an issuer determined through its reasonable country of origin inquiry that any of its conflict minerals originated in the Covered Countries, or if the issuer was unable to determine after a reasonable country of origin inquiry that its conflict minerals did not originate in the Covered Countries, the proposed rules would have required the issuer to disclose this result in the body of its annual report and disclose that the Conflict Minerals Report was furnished as an exhibit to its annual report. Additionally, the issuer would have been required to make available its Conflict Minerals Report on its Internet website until its subsequent annual report was filed, disclose in the body of its annual report that the Conflict Minerals Report was posted on its Internet

461 See Exchange Act Section 13(p)(1)(E). The issuer would be required to keep this information on its Internet website until it filed is subsequent annual report.

website, and provide the Internet address on which the Conflict Minerals Report was located.[462] Under the proposed rules, such an issuer would have been required to post the Conflict Minerals Report on its Internet website, but the issuer would not have had to post any of the disclosures it provided in the body of its annual report on its website.

**b. Comments on the Proposed Rules**

Almost all of those that commented on this point believed that the final rule should require some very brief discussion of the conflict minerals information in the body of the annual report.[463] Some commentators indicated, however, that an issuer should not have to provide any disclosure in the body of the annual report,[464] and one commentator stated that an issuer should not have to describe the findings of its Conflict Minerals Report in the body of the annual report.[465] Other commentators remarked that the full text of the Conflict Minerals Report could be provided as an exhibit to an issuer's annual report.[466] In contrast, a few commentators asserted that an issuer should be required to include its full country of origin disclosure and the full text of its Conflict Minerals Report in the body of the annual report.[467]

A number of commentators agreed that, as proposed, an issuer with conflict minerals that did not originate in the Covered Countries should be required to disclose its

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[462] See Exchange Act Section 13(p)(1)(E).

[463] See, e.g., letters from AngloGold, Howland, NEI, NY State Bar, SEMI, SIF I, and TriQuint I.

[464] See letters from ITIC I and WGC II.

[465] See letter from NY State Bar.

[466] See letters from Ford, NEI, and WGC II.

[467] See letters from CRS I and Earthworks.

reasonable country of inquiry because not requiring such disclosure would undercut the essential purpose of the Conflict Minerals Statutory Provision.[468] A number of other commentators, however, disagreed,[469] and some of these commentators justified their position by noting that the Conflict Minerals Statutory Provision does not require such disclosure and asserted that such disclosure would not serve any constructive purpose.[470] Also, of the many commentators that discussed this topic,[471] one asserted that an issuer with no conflict minerals from the Covered Countries should be required to disclose the name of the country from which its conflict minerals' originated so that investors could determine the veracity of the conclusion.[472]

Most of the commentators that discussed the topic agreed that, as proposed, an issuer should be required to maintain reviewable business records when it determines that its conflict minerals did not originate in the Covered Countries.[473] These commentators disagreed, however, about the length of time that the final rule should require the records be kept. The suggested durations ranged from one year to a period covering the duration

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468 See, e.g., letters from CRS I, Earthworks, Hileman Consulting, Methodist Pension, MSG I, NEI, TIC, Tiffany, and TriQuint I.

469 See, e.g., letters from AngloGold, Cleary Gottlieb, Howland, NMA II, NY State Bar, SEMI, and WGC II.

470 See letters from Cleary Gottlieb, NY State Bar, and SEMI.

471 See, e.g., letters from AngloGold, Global Tungsten I, Howland, IPC I, ITRI I, JVC et al. II, NAM I, NEI, NMA II, RMA, SEMI, State II, TIC, TriQuint I, and WGC II.

472 See letter from SIF I. See also letter from State II (noting that such a requirement would encourage issuers to establish due diligence procedures across their conflict mineral supply chains regardless of the minerals' country of origin).

473 See, e.g., letters from AngloGold, Columban Center et al., CRS I, Hileman Consulting, Earthworks, Global Witness I, Howland, ICGLR, JVC et al. II, Kemet, MSG I, NEI, NMA II, Sen. Durbin / Rep. McDermott, SIF I, State II, TIAA-CREF, TIC, TriQuint I, and WGC II.

of the law.[474] In addition, some commentators recommended that the final rule clarify the meaning of "reviewable business records."[475] There were a few commentators, however, that did not believe that the final rule should require an issuer to retain reviewable business records at all because such a requirement is not in the Conflict Minerals Statutory Provision, an issuer should be permitted to create its own records as it does for the financial and other information in its annual reports, and such a rule would provide an independent books and records requirement that goes beyond the Conflict Minerals Statutory Provision.[476]

**c. Final Rule**

After considering the comments, we are modifying the proposal regarding the substantive disclosures in the body of the specialized disclosure report, in part. An issuer that determines that, following its reasonable country of origin inquiry, its conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources or has no reason to believe that its necessary conflict minerals may have originated in the Covered Countries or may not be from recycled or scrap sources, is required to make certain disclosures in the body of its specialized disclosure report on Form SD,[477] under the "Conflict Minerals Disclosure" heading. This requirement is

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[474] Suggested durations included, "multiple years," "a sufficiently long period of time," "as long as their home jurisdictions (of foreign private issuers) require," "for the duration of the law," one year, two years, three years, five years, seven years, and 10 years. See, e.g., letters from AngloGold, Columban Center et al., CRS I, Earthworks, Global Witness I, Hileman Consulting, Howland, ICGLR, Kemet, MSG I, NEI, NMA II, Sen. Durbin / Rep. McDermott, SIF I, State II, TIC, TriQuint I, Trott, and WGC II.

[475] See letters from JVC et al. II and TIC.

[476] See letters from Cleary Gottlieb, NAM I, SEMI, and Tiffany.

[477] As discussed above, the final rule will require that all disclosure be in the body of the issuer's specialized disclosure report on new Form SD instead of its annual report.

generally consistent with the proposal, except that the proposal required due diligence regarding conflict minerals from recycled or scrap sources. An issuer determining that its conflict minerals that did not originate in the Covered Countries or that came from recycled or scrap sources or that has no reason to believe that its necessary conflict minerals may have originated in the Covered Countries or may not be from recycled or scrap sources must disclose its determination and results and provide a brief description of the inquiry it undertook and the results and provide a link to its Internet website where the disclosure is publicly available. However, in a change from the proposal, the final rule requires such an issuer to provide a brief description of the results of the inquiry it performed to demonstrate the basis for concluding that it is not required to submit a Conflict Minerals Report.

As discussed above, we note that there may be instances in which an issuer determines, based on its reasonable country of origin inquiry, that it has reason to believe it has conflict minerals that may have originated in the Covered Countries and may not be from recycled or scrap sources and, therefore, must exercise due diligence on the source and chain of custody of the conflict minerals. If, at any point during the exercise of that due diligence, the issuer determines that its conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources, the issuer is not required to submit a Conflict Minerals Report. The issuer, however, is still required to submit a specialized disclosure report disclosing its determination and briefly describing the reasonable country of origin inquiry and the due diligence efforts it exercised and the results of the inquiry and due diligence efforts to demonstrate why the issuer believes that the conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources.

We note the views of some commentators that requiring issuers to describe their reasonable country of origin inquiry would impose costs neither justified nor required by the provision. Also, we note that the Conflict Minerals Statutory Provision requires only that a "person described" disclose annually "whether conflict minerals that are necessary…did originate in the Democratic Republic of the Congo or an adjoining country and, in cases in which such conflict minerals did originate in any such country, submit to the Commission a report."[478] Therefore, the Conflict Minerals Statutory Provision only explicitly requires an issuer to provide additional disclosure if the issuer determines that its conflict minerals did originate in the Covered Countries.[479]

We believe, however, that requiring an issuer to provide a brief description of the reasonable country of origin inquiry it undertook is appropriate despite the additional costs associated with providing such a description. As discussed above, the reasonable country of origin inquiry is not a prescriptive standard and does not require certainty. As a result, there will likely be variation in the approaches taken by issuers. Consequently, we believe it is appropriate to require disclosure regarding the reasonable country of origin inquiry so that interested parties can evaluate "the degree of care" the issuer used

[478] See Exchange Act Section 13(p)(1)(A).

[479] See, e.g., letter from Cleary Gottlieb. This commentator argued "an issuer that concludes it has necessary conflict minerals that did not (emphasis in original) originate in the Covered Countries must only disclose that conclusion – there is no requirement in the Dodd-Frank Act for disclosure of the inquiry process the issuer undertook in coming to that conclusion," because the provision "only provides for increased disclosure requirements…once an issuer has affirmatively determined that its necessary conflict minerals originated in a DRC country." Id.

in making its negative determination,[480] and it will "help ensure credibility of issuer disclosure."[481] Also, although the Conflict Minerals Statutory Provision does not explicitly require an issuer to provide further disclosure if the issuer determines that its conflict minerals did not originate in the Covered Countries, the provision does not provide that such disclosures cannot be required. Therefore, we believe that requiring this disclosure is permitted as well as appropriate.

As described above, the final rule does not prescribe particular steps or require an issuer to establish to a certainty that its minerals did not originate in the Covered Countries or come from recycled or scrap sources. Instead, the final rule relies on a reasonable design and good faith execution approach. Requiring an issuer to briefly describe the results of the inquiry it performed is intended to enable stakeholders to assess the issuer's reasonable country of origin design and its efforts in carrying out that design. Also, this disclosure is intended to allow stakeholders to form their own views on the reasonableness of the issuer's efforts. Based on this information, stakeholders could advocate for different processes for individual issuers if they believe it is necessary.[482] In addition, it is expected that reasonable country of origin inquiry processes will change over time based both on improved supply chain visibility and the results of an issuer's prior year inquiry. Requiring an issuer to provide a brief description of the results of its

[480] See letter from MSG I.

[481] See letter from NEI.

[482] In this regard, an issuer's description of the results of the reasonable country of origin inquiry should make clear why it determined that its conflict minerals did not originate in the Covered Countries. This is also the case for issuers that must disclose their reasonable country of origin inquiry and due diligence efforts if they determine, following their due diligence, that their conflict minerals did not originate in the Covered Countries or did come from recycled or scrap sources.

inquiry, therefore, will allow stakeholders to track that progress and advocate for different procedures if they think it is necessary.

We have decided, however, not to adopt the proposed requirement for an issuer to maintain reviewable business records supporting its conclusion that its conflict minerals did not originate in the Covered Countries based on its reasonable country of origin. The Conflict Minerals Statutory Provision does not require an issuer to maintain reviewable business records to support its determination of the source of its conflict minerals. In addition, there does not appear to be a need for the rule to require that an issuer maintain such records. As one commentator noted, issuers "provide vast amounts of material information in, for example, Management's Discussion and Analysis in periodic reports, for which the SEC does not impose specific record retention requirements for maintaining the source materials used to generate the disclosures."[483] Therefore, we believe that it is unnecessary for us to require an issuer to maintain reviewable business records, although maintenance of appropriate records may be useful in demonstrating compliance with the final rule, and may be required by any nationally or internationally recognized due diligence framework applied by an issuer.

Also, in contrast to the proposal, we are not requiring an issuer to disclose in either its specialized disclosure report or its annual report, under a separate heading entitled "Conflict Minerals Disclosure," whether any of its necessary conflict minerals originated in the Covered Countries or did not come from recycled or scrap sources or that the issuer was unable to determine that its conflict minerals did not originate in the

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[483] See letter from NAM I. [illegible]

Covered Countries or come from recycled or scrap sources. Under the proposal, an issuer required to provide a Conflict Minerals Report, including an issuer required to provide a Conflict Minerals Report because its conflict minerals came from the recycled or scrap sources, would have been required to disclose in the body of its annual report that it furnished a Conflict Minerals Report as an exhibit to its annual report, that the Conflict Minerals Report and certified independent private sector audit report were available on its Internet website, and the Internet address where the Conflict Minerals Report and audit report were located. Instead, to reduce some costs and burdens to issuers, the final rule only requires an issuer required to provide a Conflict Minerals Report to disclose in its specialized disclosure report, under a separate heading entitled "Conflict Minerals Disclosure," that a Conflict Minerals Report is provided as an exhibit to its specialized disclosure report and to disclose a link to its Internet website where the Conflict Minerals Report is publicly available.

The final rule does not require an issuer to disclose in the body of its specialized disclosure report the reason that the issuer is providing a Conflict Minerals Report because that information will be disclosed by the issuer in the Conflict Minerals Report. Requiring that information also in the body of the specialized disclosure report would be redundant and unnecessary. Similarly, the final rule does not require an issuer to disclose in its specialized disclosure report that it has provided an audit report or a certification of the audit, if applicable, because the audit report and certification would be part of the Conflict Minerals Report already, so specifically mentioning the audit report or certification here is not necessary and may be confusing.

## E. Step Three – Conflict Minerals Report's Content and Supply Chain Due Diligence

The Conflict Minerals Statutory Provision requires an issuer that determines that its necessary conflict minerals originated in the Covered Countries to submit a Conflict Minerals Report.[484] The Conflict Minerals Report must include, among other matters, a description of the measures taken by the issuer to exercise due diligence on the source and chain of custody of its conflict minerals, which measures "shall include an independent private sector audit" of the Conflict Minerals Report.[485] In this regard, the Conflict Minerals Statutory Provision states also that the issuer submitting the Conflict Minerals Report "shall certify the audit…that is included in such report" and such a certified audit "shall constitute a critical component of due diligence in establishing the source and chain of custody of such minerals."[486] Also, the Conflict Minerals Statutory Provision requires that the Conflict Minerals Report must provide a description of the products "manufactured or contracted to be manufactured that are not 'DRC conflict free,'" the entity that conducted the independent private sector audit, the facilities used to process the conflict minerals, the country of origin of the conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity.[487]

### 1. Content of the Conflict Minerals Report

#### a. Proposed Rules

The proposed rules would have required an issuer to exercise due diligence on the

[484] See Exchange Act Section 13(p)(1)(A).

[485] See Exchange Act Section 13(p)(1)(A)(i).

[486] See Exchange Act Section 13(p)(1)(B).

[487] See Exchange Act Section 13(p)(1)(A)(ii).

source and chain of custody of its conflict minerals that it was unable to determine, based on its reasonable country of origin inquiry, did not originate in the Covered Countries and to describe those due diligence measures in its Conflict Minerals Report. Consistent with the Conflict Minerals Statutory Provision,[488] we proposed to require that the description of the measures taken by an issuer to exercise due diligence on the source and chain of custody of its conflict minerals would include a certified independent private sector audit conducted in accordance with the standards established by the Comptroller General of the United States.[489] The proposed rules also stated that the audit would constitute a critical component of due diligence.[490] To implement the Conflict Minerals Statutory Provision's requirement that an issuer "certify the audit,"[491] we proposed that an issuer would be required to certify that it obtained an independent private sector audit of its Conflict Minerals Report,[492] and we proposed that an issuer would provide this certification in that report. Further, as required by the Conflict Minerals Statutory Provision,[493] we proposed that the rules would require descriptions, in the Conflict Minerals Report, of an issuer's products that are not "DRC conflict free," the facilities used to process those conflict minerals, the country of origin of those conflict minerals,

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488 See Exchange Act Sections 13(p)(1)(A)(i) and 13(p)(1)(B).

489 See Exchange Act Section 13(p)(1)(A).

490 See Exchange Act Section 13(p)(1)(B).

491 See id.

492 As discussed in the Proposing Release, alternatively, one could interpret this language to mean that an issuer must ensure that the audit it obtained is accurate, but such an interpretation would appear to mean that an issuer must review the audit of its Conflict Minerals Report, which the issuer created originally. We did not propose this approach.

493 See Exchange Act Section 13(p)(1)(A)(ii).

and the efforts to determine the mine or location of origin with the greatest possible specificity.

The Conflict Minerals Statutory Provision uses the phrase "facilities used to process the conflict minerals," which we noted in the Proposing Release would appear to refer to the smelter or refinery through which the issuer's minerals passed. We noted also that the Conflict Minerals Statutory Provision states that products are "DRC conflict free" when those products do not contain conflict minerals that directly or indirectly finance or benefit armed groups.[494] The Proposing Release also noted that Section 1502(e)(3) of the Act defines the term "armed group" as "an armed group that is identified as perpetrators of serious human rights abuses in the annual Country Reports on Human Rights Practices under sections 116(d) and 502B(b) of the Foreign Assistance Act of 1961,"[495] as they relate to the Covered Countries ("Country Reports").[496] Our proposed rules included a cross reference to that definition to provide guidance.

Under the proposed rules, an issuer that was unable to determine that its conflict minerals did not originate in the Covered Countries would have been required to furnish a Conflict Minerals Report to the same extent as an issuer with conflict minerals that originated in the Covered Countries. We recognized that an issuer unable to determine that its conflict minerals did not originate in the Covered Countries may not be able to determine to a certainty whether any of its products are or are not "DRC conflict free," insofar as its initial effort to determine the origin of the conflict minerals in those

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494 See Exchange Act Sections 13(p)(1)(A)(ii) and 13(p)(1)(D).

495 22 U.S.C. 2151n(d) and 2304(b).

496 Section 1502(e)(3) of the Act.

products under the reasonable country of origin inquiry was inconclusive and its subsequent due diligence on the source and chain of custody of such minerals was also inconclusive. Consistent with Exchange Act Section 13(p)(1)(A)(ii), we proposed that an issuer unable to determine that its conflict minerals did not originate in the Covered Countries would be required to describe all of its products that contain such conflict minerals and identify these products as "not DRC conflict free"[497] because the issuer would not have determined that the products satisfied the statutory definition of "DRC conflict free"—that the products do "not contain conflict minerals that directly or indirectly finance or benefit armed groups in the" Covered Countries. The proposed rules would have allowed an issuer to provide additional disclosure explaining, for example, that although these products were categorized as not "DRC conflict free" in compliance with the proposed rules implementing the Conflict Minerals Statutory Provision and the statutory definition of "DRC conflict free," the issuer had been unable to determine the source of the conflict minerals, including whether the conflict minerals in these products actually benefited or financed armed groups in the Covered Countries. Also, such an issuer would have been required to describe, to the extent known after conducting due diligence, the facilities used to process those conflict minerals and the efforts to

[497] If any products contained both conflict minerals that did not originate in the Covered Countries and conflict minerals that the issuer was unable to determine did not originate in the Covered Countries, the issuer, under the proposal, would be required to classify those products as not "DRC conflict free." Similarly, if any of an issuer's products contained conflict minerals that did not originate in the Covered Countries, that the issuer was unable to determine did not originate in the Covered Countries, or that originated in the Covered Countries but did not directly or indirectly finance or benefit armed groups in the Covered Countries, and also contained conflict minerals that originated in the Covered Countries and that directly or indirectly financed or benefited armed groups in the Covered Countries, the issuer would be required to classify those products as not "DRC conflict free."

determine the mine or location of origin with the greatest possible specificity.[498]

Any issuer with products considered not "DRC conflict free" would have been required to provide a description of those products in its Conflict Minerals Report. That description would have been based on the issuer's individual facts and circumstances so that the description sufficiently identified the products or categories of products. For example, an issuer could disclose each model of a product containing conflict minerals that directly or indirectly financed or benefited armed groups in the Covered Countries, each category of a product containing such conflict minerals, the specific products containing such conflict minerals that were produced during a specific time period, that all its products contain such conflict minerals, or another such description depending on the issuer's facts and circumstances.

As proposed, our rules would have required an issuer to furnish, as part of its Conflict Minerals Report, the audit report prepared by the independent private sector auditor and the identity of the auditor.[499] We noted that, while one might read the statutory language to suggest that only the issuer's certification of the audit, and not the audit report itself, is required to be submitted, we preliminarily believed that approach was not the better reading of the Conflict Minerals Statutory Provision. As noted above, the Conflict Minerals Statutory Provision emphasizes that the independent audit is a "critical component of due diligence." In light of the importance of this audit report to

[498] We recognized that such an issuer would not be able to provide the country of origin of those minerals, so the proposed rules would not require this information.

[499] Our proposal to require the issuer to identify the certified independent private sector auditor would satisfy Exchange Act Section 13(p)(1)(A)(ii), which states that the issuer must provide a description of "the entity that conducted the independent private sector audit in accordance with clause (i)."

the proposed reporting requirements and the statutory language, we proposed to require that the audit report be furnished with the Conflict Minerals Report.

Proposed Item 4(a) of Form 10-K (referring to proposed Instruction 2 to Item 104 of Regulation S-K), proposed Instruction 3 to Item 16 of Form 20-F, and proposed Instruction 3 to General Instruction B(16) of Form 40-F would have provided that the Conflict Minerals Report, which would include the audit report, would not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the issuer specifically incorporated it by reference. For example, if an issuer incorporated by reference its annual report into a Securities Act registration statement, that issuer would not also automatically incorporate the Conflict Minerals Report into that Securities Act document. Also, in such a situation, the independent private sector auditor would not have assumed expert liability and the issuer would not,[500] therefore, have been required to file a consent from that auditor unless the issuer specifically incorporated by reference the Conflict Minerals Report into the Securities Act registration statement.

b. **Comments on the Proposed Rules**

A number of commentators agreed with the proposed rules' requirement that an issuer unable to determine that its conflict minerals did not originate in the Covered Countries be required to describe its products as not "DRC conflict free" in its Conflict

[500] See Rule 436 of Regulation C [17 CFR 230.436].

Minerals Report.[501] In one comment letter, five senators stated that Congress did not intend for the Conflict Minerals Statutory Provision to allow issuers to report that the origins of their conflict minerals was undeterminable.[502] Instead, the letter argued that Congress "intended and directed" the final rule to require that, if an issuer "cannot affirm that the minerals are 'conflict-free,' the only other conclusion that could be reported would be that the product may contain materials that directly or indirectly finance armed groups in the DRC."[503] In another comment letter, members of Congress asserted that conflict minerals information that does "not clearly list a company's activities and rules allowing a category of 'indeterminate' would undermine congressional intent."[504]

Other commentators indicated, however, that the final rule should not require an issuer unable to determine that its conflict minerals did not originate in the Covered Countries to state that its conflict minerals are not "DRC conflict free" either on a temporary or permanent basis.[505] Some commentators who are members of Congress requested that we consider, as an alternative to the proposed rules, "phasing-in implementation to allow for materials of indeterminate origin currently in the supply chain to be properly classified."[506] In another letter, members of Congress suggested that

[501] See, e.g., letters from CRS I, Earthworks, Evangelical Alliance, Evangelicals, Howland, Methodist Board, NEI, Presbyterian Church II, Rep. Berman et al., Sen. Boxer et al. II, Sen. Durbin / Rep. McDermott, State II, and World Vision II.

[502] See letter from Sen. Boxer et al. II.

[503] Id.

[504] See letter from Sen. Leahy et al.

[505] See, e.g., letters from AdvaMed I, Cleary Gottlieb, IPC I, ITRI I, JVC et al. II, NAM I, NAM III, Rep. Bachus et al., Rep. Critz, Rep. Ellmers, Rep. Murphy, TIAA-CREF, Tiffany, TriQuint I, and WGC II.

[506] See letters from Rep. Critz, Rep. Ellmers, and Rep. Murphy.

the final rule create a temporary classification for minerals of an indeterminate origin that would exempt companies with such minerals from the requirement to provide a Conflict Minerals Report.[507] Some commentators suggested that such issuers should be required to state that its products with such conflict minerals are not "DRC conflict free" after a certain number of years.[508] Some commentators asserted that the proposed rules would violate the First Amendment because, among other reasons, the rules would compel speech that is not of a commercial nature, which is different from other corporate disclosures, and would require some issuers, such as those unable to determine that their conflict minerals did not originate in the Covered Countries, to provide false, stigmatizing information.[509]

Some commentators urged that an issuer unable to determine that its conflict minerals did not originate in the Covered Countries should not be required to submit a Conflict Minerals Report that is audited by an independent private sector auditor.[510] As one commentator asserted, the provision "does not require an issuer that has been unable to determine (after proper inquiry) the source of its conflict minerals…to provide a Conflict Minerals Report," because the "statute uses the phrase 'in cases in which such conflict minerals did originate in [a DRC country],' as the trigger for providing a Conflict Minerals Report" (emphasis and bracket in original).[511]

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[507] See letter from Rep. Bachus et al.

[508] See letters from IPC I, SIF I, TIAA-CREF, and TriQuint I.

[509] See letters from Taiwan Semi, Tiffany, and WLF.

[510] See, e.g., letters from AngloGold, Cleary Gottlieb, NAM I, and Tiffany.

[511] See letter from Cleary Gottlieb.

One commentator, in two separate letters, disagreed with this position, however, and stated that any issuer that is unable to determine that its conflict minerals did not originate in the Covered Countries must be required to submit an audited Conflict Minerals Report to support its conclusion.[512] Another commentator recommended that the final rule allow issuers to provide annual, unaudited conflict minerals disclosure that would identify the issuer's products that the issuer "reasonably believes may contain 'conflict minerals;'" indicate that the origin of these minerals is indeterminate and explain why the minerals origin is indeterminate; identify and disclose the issuer's involvement in any governmental, semi-governmental, and private sector diligence initiatives; and describe the measures the issuer has undertaken to develop a management due diligence system covering its supply chain for each conflict mineral.[513] One commentator asserted that investors would have "insufficient material information to evaluate a company's supply chain risk" if the final rule allowed issuers to declare their conflict minerals from an indeterminate origin "without describing the steps they have taken to make their determination," and recommended that the final rule "require reporting to be sufficiently detailed to inform investors of the steps an issuer has taken to determine whether the minerals the issuer purchases come from the DRC or an adjoining

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[512] See letters from NYCBar I ("We also believe the rules should require reporting firms that cannot, after due diligence, determine the origin of the materials used in their products to submit a Conflict Minerals Report and an independent audit of such report to ensure such issuers cannot easily avoid their obligations and disclosure requirements prescribed by these rules.") and NYCBar II ("The rules should require reporting firms that cannot, after due diligence, determine the origin of the materials used in their products to submit a Conflict Minerals Report and an independent audit of such report to ensure such issuers cannot easily avoid their obligations and disclosure requirements prescribed by the rules.").

[513] See letter from Signet.

country."[514]

Although we did not propose to require any type of physical label on a product, one commentator stated that it is essential for the final rule to mandate that an issuer with products containing conflict minerals that did not finance or benefit an armed group label those products as "DRC conflict free."[515] Many commentators, however, remarked that an issuer should not be required to physically label its products.[516] Some commentators asserted that an issuer should be permitted to describe its products as "DRC conflict free" only if the issuer sources its conflict minerals in those products from the Covered Countries and those conflict minerals did not finance or benefit armed groups.[517] Another commentator added specifically that products should be labeled as "DRC conflict free" only if either they are not from the Covered Countries or do not directly or indirectly support armed groups in the Covered Countries.[518] Also, all commentators that discussed the subject agreed that the final rule should, as proposed, allow issuers to provide additional disclosure in describing any of their products that have not been found to be "DRC conflict free".[519]

A number of commentators mentioned that the final rule should, as proposed,

[514] See letter from SIF II.

[515] See, e.g., letter from Catholic Relief Services of St. Cloud, Minnesota (Apr. 14, 2011) ("CRS I – St. Cloud").

[516] See, e.g., letters from Columban Center et al., Howland, Industry Group Coalition I, ITIC I, Japanese Trade Associations, MSG I, NAM I, and SIF I.

[517] See letters from ITRI III, MSG I, and SIF I.

[518] See letter from State II.

[519] See letters from Howland, IPC I, NMA II, SEMI, TriQuint I, and WGC II.

require an issuer to disclose the facilities, countries of origin, and efforts to determine the mine or location of origin only for its conflict minerals that directly or indirectly financed or benefited armed groups in the Covered Countries.[520] A few commentators suggested that all issuers with conflict minerals originating in the Covered Countries, including issuers with conflict minerals that did not directly or indirectly finance or benefit armed groups in the Covered Countries and issuers with conflict minerals that did directly or indirectly finance or benefit armed groups in the Covered Countries, should be required to disclose the facilities, countries of origin, and efforts to determine the mine or location of origin of those conflict minerals.[521] Two commentators further recommended that all issuers with conflict minerals, regardless of whether the minerals originated within or without of the Covered Countries, should be required to disclose the facilities, countries of origin, and efforts to determine the mine or location of origin of those conflict minerals.[522]

Some commentators agreed that the final rule should, as proposed, require an issuer to disclose only the efforts to determine the conflict minerals' mine or location of origin with the greatest possible specificity.[523] Other commentators suggested going further and requiring an issuer to disclose the actual mine or location of origin with the

[520] See, e.g., letter from AngloGold, Barrick Gold, Cleary Gottlieb, Howland, IPC I, JVC et al. II, NAM I, NMA II, and WGC II.

[521] See letters from MSG I, NEI, SIF I, and TriQuint I.

[522] See letters from Earthworks and Trott.

[523] See, e.g., letters from AngloGold, Barrick Gold, JVC et al. II, NAM I, TriQuint I, and WGC II.

greatest possible specificity.[524] Still other commentators argued that the final rule should not require issuers to include specific supply chain information, such as conflict mineral sources, quantities, transit routes, or store houses because such disclosures could hurt an issuer's competitive advantage or subject the issuer or its employees to violence.[525] Alternatively, these commentators recommended that the rule allow for generic descriptions or approximate geographic locations or permit an issuer to redact sensitive or secure information.[526]

A number of commentators indicated that an issuer should, as proposed, "certify the audit" by certifying that it obtained an independent private sector audit.[527] Many of these commentators, plus some others, remarked that these certifications should either not be signed or, if they are required to be signed, be signed by the issuer or by an individual on behalf of the issuer and not in any individual capacity.[528] In contrast, one commentator recommended that an issuer's senior management or executive officers in some manner certify the independent private sector audit,[529] another commentator asserted that it is "essential that there be CEO level involvement in the filing of the

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524 See, e.g., letters from CRS I, Howland, ICGLR, NEI, State II (acknowledging that, as a best practices approach, an issuer should make every effort to include specific information regarding the mine), TakeBack, and Trott (stating that the final rule should require an issuer to provide as much information as possible regarding its conflict minerals' mine or location of origin).

525 See letters from Barrick Gold, Global Tungsten II, IPMI I, NMA II, NMA III, and TIC.

526 See letters from Barrick Gold, NMA II, and TIC.

527 See, e.g., letters from Barrick Gold, Cleary Gottlieb, Ford, ICGLR, ITIC I, NAM I, NY State Bar, and WGC II.

528 See, e.g., letters from AngloGold, Barrick Gold, Cleary Gottlieb, Ford, Howland, JVC et al. II, NAM I, NEI, and WGC II.

529 See letter from Grant Thornton LLP (Mar. 2, 2011) ("Grant Thornton").

disclosures in order to make sure that companies do not simply 'game the system,'"[530] and a further commentator argued that the "certification of an audit will make little sense unless the signatories verify on a quarterly basis that certain minimal standards have been maintained by the auditors."[531] One commentator asserted that certifying the audit is unnecessary because the audit report will be submitted to the Commission in the Conflict Minerals Report.[532] This commentator and another stated that requiring an issuer to certify the audit would prevent an issuer from stating that its products are "DRC conflict free" because no issuer could be so certain of that conclusion that its officers would certify the audit.[533] One commentator suggested that no liability should be assigned to individuals that may sign the certifications "unless the situation involves a knowing and willful intent to mislead."[534]

Some commentators agreed that the audit report should, as proposed, be included as part of the Conflict Minerals Report.[535] Other commentators recommended that an issuer's audit report should not be submitted as part of the Conflict Minerals Report because such a requirement would increase audit costs without providing comparable benefits.[536] Certain commentators opposed having to make the audit report public and

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[530] See letter from TakeBack.

[531] See letter from SARW.

[532] See letter from TIC.

[533] See letters from Teggeman and TIC.

[534] See letters from Cleary Gottlieb and NMA II.

[535] See, e.g., letters from Howland, NEI, and Sen. Durbin / Rep. McDermott.

[536] See letters from AngloGold and WGC II.

suggested instead that issuers provide the audit report to the Commission confidentially, allow for sensitive portions to be redacted, or provide it to the Commission with the Commission making it available to the public only in hardcopy form at the Commission's headquarters.[537] Similarly, one commentator objected to requiring an issuer to post the audit report on the issuer's Internet website as long as the Conflict Minerals Report describes the audit report,[538] whereas another commentator argued that the final rule should require an issuer to post the audit report on an issuer's website.[539]

Some commentators indicated that, as proposed, an audit report should not be deemed incorporated by reference into any filing under the Securities Act or Exchange Act unless the issuer specifically incorporates the audit into such a filing.[540] A few commentators further suggested that an auditor should not be considered an "expert" under Rule 436 of the Securities Act and recommended that audit reports submitted in subsequent years be able to build off prior audit reports to eliminate duplicative work and, thereby, reduce costs.[541] One commentator went further and suggested that any issuer with a recognized supply chain tracking process should not be required to obtain an audit of its Conflict Minerals Report.[542]

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537 See, e.g., letters from Barrick Gold, Materials Management Corporation (Jan. 13, 2011) ("Materials I"), NAM I, and NMA II.

538 See letter from ITIC I.

539 See letter from Columban Center et al.

540 See, e.g., letters from Barrick Gold, Cleary Gottlieb, Corporate Secretaries I, NY State Bar, and WGC II.

541 See letters from NY State Bar and WGC II.

542 See letter from TIC.

Some commentators requested that the final rule define how an issuer would "directly or indirectly finance or benefit an armed group."[543] Some of these commentators and others recommended that the Country Reports not be the basis for the Commission's final rule because those reports are not sufficiently specific with respect to which groups it labels as "armed groups" such that it is unclear whether the DRC army would be considered an "armed group."[544] For example, one commentator submitted an article arguing that the Conflict Minerals Statutory Provision "targets units of the Congolese army as much as it does militias precisely because the army is comprised largely of ex-rebels, is the major player in the conflict minerals trade and regularly commits appalling crimes against the civilian population."[545] Another commentator, however, stated that if the final rule defined "armed group" using the Country Reports, it would exclude the ex-militia groups that joined the DRC armed forces but continue to contribute to conflict and commit human rights violations.[546] One commentator recommended that the final rule define "armed group" using the OECD's definition for that term.[547] Another commentator suggested that the final rule apply only to issuers that are "directly funding the conflict (or who knowingly indirectly fund the conflict)."[548]

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[543] See, e.g., letters from NMA II, Peace, and WGC II.

[544] See letters from ITRI I, NMA II, NYCBar I, and Peace. See also letter from NYCBar II (stating specifically that the final rule should include "the Congolese military (FARDC) in its definition of 'armed group'").

[545] See letter from ICAR II.

[546] See letter from Save.

[547] See letter from Pact II.

[548] See letter from CEI I.

One commentator recommended that the final rule define "indirect financing" of an armed group to include "[a]ny way in which an illegitimate armed group profits from the mining, sale, transportation or taxation of minerals or mineral derivatives."[549] Some commentators asserted that the final rule should clarify the definition of an "armed group" or disclose the steps issuers must take to verify whether their conflict minerals benefited armed groups.[550] Other commentators suggested that the definition of "armed group" in the final rule should not refer to the "most recently issued" version of the Country Reports "for the year the annual report is due" because the most recently issued version of the Country Reports may not be published for the year the annual report is due.[551]

c. **Final Rule**

The final rule requires any issuer that, after its reasonable country of origin inquiry, knows that its conflict minerals originated in the Covered Countries and did not come from recycled or scrap sources to provide a Conflict Minerals Report that includes a description of the measures the issuer has taken to exercise due diligence on the source and chain of custody of those conflict minerals. It also requires an issuer that, after its reasonable country of origin inquiry, had reason to believe that its minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources and, after the exercise of due diligence, still has reason to believe that its minerals may have originated in the Covered Countries and may not have come from recycled or

549 See letter from Peace.

550 See, e.g., letters from CRS I – St. Cloud, ITRI I, NMA II, NYCBar I, Peace, and TIC.

551 See, e.g., letters from ITRI I and TIC.

scrap sources, to provide a Conflict Minerals Report that includes a description of the measures the issuer has taken to exercise due diligence on the source and chain of custody of those conflict minerals.

Additionally, in circumstances in which an independent private sector audit is required, the final rule requires, as proposed, that an issuer include a certified independent private sector audit conducted in accordance with the standards established by the Comptroller General of the United States as part of its due diligence on the source and chain of custody of its conflict minerals. Further, the final rule states that, as proposed, the audit constitutes a critical component of due diligence. To implement the Conflict Minerals Statutory Provision's requirement that issuers "certify the audit,"[552] as proposed, an issuer must certify that it obtained an independent private sector audit of its Conflict Minerals Report and include that certification in the Conflict Minerals Report.[553] While we did not specify this in the Proposing Release or proposed rules, in response to commentators' concerns, the final rule clarifies that the issuer's audit certification need not be signed by an officer. Instead, the certification takes the form of a statement in the Conflict Minerals Report that the issuer obtained an independent private sector audit.

The final rule also requires, unless an issuer's products are "DRC conflict free," the Conflict Minerals Report to include a description of the facilities used to process those conflict minerals, the country of origin of those conflict minerals, and the efforts to

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[552] Exchange Act Section 13(p)(1)(B).

[553] We are not adopting the alternative interpretation of the Conflict Minerals Statutory Provision that an issuer must ensure that the audit it obtained is accurate. The Conflict Minerals Report contains management's assertions related to compliance with this rule; the third-party audit is designed to attest to certain of those assertions. Given this relationship, there does not appear to be a need to have management assert to the accuracy of the audit.

determine the mine or location of origin with the greatest possible specificity. As noted in the Proposing Release, we believe that the phrase in the Conflict Minerals Statutory Provision, "facilities used to process the conflict minerals," refers to the smelter or refinery through which the issuer's minerals pass. One commentator pointed out that smelting and refining processes are not similar.[554] Smelting refers to the conversion of the mineral ore into its metal form, but the metal still contains many impurities that must be removed by refining the metal. Columbite-tantalite, cassiterite, and wolframite are mined only as ores and are smelted into their metal derivatives. Gold, however, is mined in its metallic form because it is found that way naturally. Therefore, gold does not have to be smelted into a metal, but does have to be refined to remove any impurities. In both instances, however, we recognize that as a practical matter it is very difficult, if not impossible, to trace conflict minerals to their mine or other location of origin after columbite-tantalite, cassiterite, and wolframite have been smelted initially and after gold has been refined initially other than through the smelter or refinery.

Exchange Act Section 13(p)(1)(A)(ii) also requires an issuer with conflict minerals originating in the Covered Countries to submit a Conflict Minerals Report that includes a description of the issuer's products "that are not DRC conflict free."[555] The Conflict Minerals Statutory Provision does not define "not DRC conflict free," but

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[554] Letter from ITRI I. In the Proposing Release, we stated that columbite-tantalite, cassiterite, and wolframite are smelted into their component metals whereas gold is refined, and we indicated that both processes are substantially similar such that, when we would refer to smelting a conflict mineral, those references were intended to include the refining of gold.

[555] See Exchange Act Section 13(p)(1)(A)(ii).

instead defines "DRC conflict free."[556] Products are considered "DRC conflict free" under Exchange Act Section 13(p)(1)(A)(ii) if they "do not contain minerals that directly or indirectly finance or benefit armed groups in the" Covered Countries. (Emphasis added).[557] As discussed above, under the proposed rules' approach, an issuer with a product containing conflict minerals of an undeterminable origin cannot know that its product is "DRC conflict free;" that is, the issuer cannot know that its product "do[es] not contain conflict minerals that directly or indirectly finance or benefit armed groups in the" Covered Countries, so the issuer would have to describe the product as "not DRC conflict free."

A commentator raised concerns that this approach could lead to incorrect and misleading disclosures and could unfairly punish companies that lack complete visibility into their supply chains.[558] The commentator noted that it could turn out that, upon further investigation of the minerals' origins, the minerals were not from the Covered Countries or did not finance or benefit armed groups, in which case the products made with solely those minerals would be "DRC conflict free." Of course, we are concerned that any disclosure requirement results in accurate disclosure. At the same time, we are cognizant of our responsibility to fulfill Congress's directive in Section 1502 and to remain faithful to the language of the statute, and promulgating rules that provide an

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[556] See id. and Exchange Act Section 13(p)(1)(D).

[557] Exchange Act Section 13(p)(1)(A)(ii). Also, although similar, the definition of "DRC conflict free" under Exchange Act Section 13(p)(1)(D) is slightly different than the definition under Exchange Act Section 13(p)(1)(A)(ii). Exchange Act Section 13(p)(1)(D) states that "a product may be labeled as 'DRC conflict free' if the product does not contain minerals that directly or indirectly finance or benefit armed groups in the" Covered Countries.

[558] See letter from Tiffany.

incentive for issuers to avoid determining the origins of the conflict minerals that they use could undermine the reporting system that Congress has established in Section 13(p) of the Exchange Act. Accordingly, we have modified the final rule to address the commentator's concerns while remaining faithful to the language and intent of the statute.

As described above, during a temporary period, instead of requiring issuers that have proceeded to step three that are unable to determine that their conflict minerals did not originate in the Covered Countries, that their conflict minerals that originated in the Covered Countries did not directly or indirectly finance or benefit armed groups, or that their conflict minerals came from recycled or scrap sources to describe their products as "not 'DRC conflict free,'" the final rule permits such issuers to describe products containing those conflict minerals as "DRC conflict undeterminable." An issuer with products that are "DRC conflict undeterminable" is required to exercise due diligence on the source and chain of custody of its conflict minerals and submit a Conflict Minerals Report describing its due diligence; the steps it has taken or will take, if any, since the end of the period covered in its most recent prior Conflict Minerals Report to mitigate the risk that its necessary conflict minerals benefit armed groups, including any steps to improve its due diligence; the country of origin of the conflict minerals, if known; the facilities used to process the conflict minerals, if known; and the efforts to determine the mine or location of origin with the greatest possible specificity, if applicable.[559] Such an

[559] We recognize that an issuer that is unable to determine the origin of its conflict minerals, or unable to determine whether it conflict minerals came from recycled or scrap sources, may not also be able to determine the processing facility of those conflict minerals and will not be able to determine the minerals' country of origin. Therefore, these issuers only have to describe the processing facilities if they are known

issuer is not, however, required to obtain an independent private sector audit of that Conflict Minerals Report. We are permitting this temporary category to address concerns of many industry commentators that supply chain due diligence mechanisms have not yet been established;[560] and, therefore, many issuers will not be able to readily determine whether their conflict minerals did not originate in the Covered Countries, did not finance or benefit armed groups, or did come from recycled or scrap sources. This temporary category should allow issuers time to establish supply chain due diligence mechanisms to determine whether their minerals originated in the Covered Countries, directly or indirectly financed or benefited armed groups in the Covered Countries, or came from recycled or scrap sources.

This additional time should also decrease the possibility that issuers that might ultimately be able to determine that their necessary minerals did not originate in the Covered Countries, did not finance or benefit armed groups, or came from recycled or scrap sources would initially be required to report that their products have not been found to be "DRC conflict free" simply because they had not yet been able to determine the minerals' origins or whether they were from recycled or scrap sources. By decreasing this possibility, the temporary category will lead to more accurate disclosure. We believe this approach will allow the final rule to more appropriately target the population of issuers from which Congress intended to require this disclosure and will allow time for

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to the issuer and do not have to disclose the country of origin. Also, an issuer that is unable to determine whether it conflict minerals came from recycled or scrap sources does not have to describe its efforts to determine the mine or location of origin with the greatest possible specificity because issuers with conflict minerals from recycled or scrap sources are not required to determine the mine or location of origin.

[560] See, e.g., letters from CTIA, FEC I, JVC et al. II, NAM III, NRF I, Roundtable, and WilmerHale.

processes to be put in place so that issuers may be able to determine the origin of their conflict minerals.

The "undeterminable" reporting alternative, however, is only permitted temporarily. For all issuers, this alternative will be permitted during the first two reporting cycles following the effectiveness of the final rule, which includes the specialized disclosure reports for 2013 through 2014. For smaller reporting companies, this alternative will be permitted during the first four reporting cycles following the effectiveness of the final rule, which includes the specialized disclosure reports for 2013 through 2016. Beginning with the third reporting period, from January 1, 2015 to December 31, 2015, for all issuers and the fifth reporting period, from January 1, 2017 to December 31, 2017, for smaller reporting companies, every such issuer will have to describe products in its Conflict Minerals Report as having "not been found to be 'DRC conflict free.'" Also, issuers will be required to make such a disclosure even if they proceed to step three and are unable to determine that their conflict minerals did not originate in the Covered Countries, that their conflict minerals that originated in the Covered Countries did not directly or indirectly finance or benefit armed groups, or that their conflict minerals came from recycled or scrap sources. These issuers will also be required to provide an independent private sector audit of their Conflict Minerals Report.[561]

While this disclosure is required after the temporary period, even when issuers are

[561] As noted below, an issuer exercising due diligence to determine whether a conflict mineral is from a recycled or scrap source is not required to obtain an independent private sector audit of its Conflict Minerals Report, regarding that conflict mineral, if there is no nationally or internationally recognized due diligence framework for that recycled or scrap conflict mineral.

unable to determine the origin of their conflict minerals, we have changed the language of the disclosure from the proposal to address concerns raised about the accuracy of the disclosure required in these circumstances. In our view, it is accurate to describe such products as having "not been found to be 'DRC conflict free.'" "DRC conflict free" is a defined term in the statute, meaning that the product "do[es] not contain conflict minerals that directly or indirectly finance or benefit armed groups in the" Covered Countries. An issuer that does not know that its conflict minerals did not originate in the Covered Countries, that its conflict minerals that originated in the Covered Countries did not finance or benefit armed groups, or that the minerals came from recycled or scrap sources cannot accurately state that its conflict minerals have been found to meet this definition; therefore, its products have not been found to be "DRC conflict free" as defined in the statute.

Additionally, under the final rule, as proposed, issuers can add disclosure or clarification. This allows issuers to include the statutory definition of "DRC conflict free" in the disclosure to make clear that "DRC conflict free" has a very specific meaning, or to otherwise address their particular situation.[562] We also believe that the

[562] For example, in addition to the disclosure in the Conflict Minerals Report, the issuer could state: "The following is a description of our products that have not been found to be "DRC conflict free" (where 'DRC conflict free' is defined under the federal securities laws to mean that a product does not contain conflict minerals necessary to the functionality or production of that product that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country)." Alternatively, an issuer that is still unable to determine the origin of some of its conflict minerals after the two-year or four-year period, might state: "We have been unable to determine the origins of some of our conflict minerals. Because we cannot determine the origins of the minerals, we are not able to state that products containing such minerals do not contain conflict minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country. Therefore, under the federal securities laws we must describe the products containing such minerals as having not been found to be 'DRC conflict free.' Those products are listed below."

revised disclosure that the products "have not been found to be 'DRC conflict free'" mitigates concerns expressed by some commentators that the Proposing Release's specific required language, "are not 'DRC conflict free,'" would impose an unfair stigma, particularly on issuers that did not know whether their minerals directly or indirectly financed or benefited armed groups in the Covered Countries.

Although it does not appear that any individual commentator suggested the exact approach we are adopting, this approach incorporates suggestions from various commentators. One commentator recommended that we adopt a "phase-in or transitional approach in order to address the substantial practical difficulties issuers currently face in seeking to trace the origins of conflict minerals included in their products and to determine if these minerals are or are not 'DRC conflict free.'"[563] This commentator's recommendation was for the final rule to include a phase-in period through 2014 in which any issuer with conflict minerals for which the issuer was unable to determine their origin would describe the conflict minerals as from an "indeterminate source" and would be permitted, instead of providing a Conflict Minerals Report, to disclose its conflict minerals policy and provide a statement that, due to the lack of current infrastructure, it is not possible to determine the origin of its conflict minerals. The commentator recommended that the "indeterminate source" category would be available only through 2014. Another commentator recommended that the final rule allow a similar phase-in period through 2014 in which issuers would be permitted to use an "unknown determination" category in which such issuers would be required only to disclose their

[563] See letter from WilmerHale.

conflict minerals policy, reasonable country of origin inquiry, and the conflict minerals used in their supply chain.[564]

Other commentators recommended similar temporary approaches for conflict minerals when an issuer could not determine the origin of its conflict minerals.[565] In this regard, one commentator noted that, "requiring issuers that are unable to determine that the conflict mineral in their products did not originate in the Covered Countries to submit a Conflict Minerals Report providing the required information that is available to them, is reasonable."[566] Also, one commentator recognized that, during the initial period after the rule is finalized, it expected that some conflict minerals would be of unknown origin, and issuers with those conflict minerals should, among other information, disclose "any progress made in the reporting year toward determination of origin."[567] Finally, some commentators suggested that smaller reporting companies should be allowed to phase-in or that the implementation of the final rule should be deferred for them.[568]

Based on the comments we have received, we believe that permitting all issuers to describe their products as "DRC conflict undeterminable" for a two-year period is

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564 See letter from AdvaMed I.

565 See, e.g., letters from TIAA-CREF ("Where the source of minerals cannot be confirmed, we believe it would be most accurate to allow companies to use indeterminate language such as 'may not be DRC conflict free,' but not language that would suggest a presumption that minerals would be conflict free absent specific evidence to the contrary. Moreover, over time the information systems necessary to trace these minerals will likely improve. We suggest that, after a reasonable time interval, the SEC consider reviewing whether a higher standard might be warranted.") and TriQuint I (recommending that the final rule "allow companies to label their products as 'May Not Be DRC Conflict Free' until such a time when it is expected that companies will be able to purchase processed conflict minerals from smelters that have been validated as 'DRC conflict free'").

566 See letter from ABA.

567 See letter from SIF I.

568 See, e.g., letters from Howland and JVC et al. II.

appropriate to allow viable tracking systems to be put in place in the Covered Countries and throughout supply chains and avoid a de-facto embargo on conflict minerals from the Covered Countries. We also believe that allowing this category for a two-year period will avoid a situation in which virtually all issuers would describe their products as having not been found to be "DRC conflict free," simply because they could not determine the origin of their conflict minerals, which would render that disclosure less meaningful.[569] Similarly, we believe that allowing smaller reporting companies four years to describe their products as "DRC conflict undeterminable" is appropriate because these issuers may lack the leverage to obtain detailed information regarding the source of a particular conflict mineral.[570]

We do not, however, believe that a permanent "DRC conflict undeterminable" category would be consistent with the language in the statute, and we believe it would undermine the overall goals of Section 1502. Such an approach might create incentives for issuers not to exercise care in identifying the origins of their necessary conflict minerals. Also, we do not believe that, after the temporary reporting period, the number of issuers that would describe their products as having not been found to be "DRC conflict free" would be so substantial as to render the disclosure meaningless because, based on our review of the comments, it appears that there should be systems in place at that time on which issuers could rely to determine whether their conflict minerals

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569 See, e.g., letters from AdvaMed I, ITIC I, and ITRI II.

570 See letters from ABA, Corporate Secretaries I, and JVC et al. II. But see letter from Green II (arguing that, although smaller reporting companies may lack leverage, this disadvantage may be reduced through the influence exerted over their suppliers by larger issuers that use the same supplier base and that have more leverage to request such information.).

originated in the Covered Countries and, if so, whether they contributed to conflict. Overall, we believe that the change from "not 'DRC conflict free'" to having "not been found to be 'DRC conflict free,'" the ability to add additional explanation and disclosure, and the periods for the "DRC conflict undeterminable" category will provide issuers who are initially unable to determine that their conflict minerals did not originate in the Covered Countries or unable to determine that their conflict minerals that originated in the Covered Countries did not directly or indirectly finance or benefit armed groups in the Covered Countries means to make their disclosure while still accomplishing the goals that Congress intended when it required the disclosure of products that are not "DRC conflict free."

We believe that this approach also responds to the First Amendment concerns raised by the commentators. As to the concern that the rule impermissibly compels speech that is not of a commercial nature, we presume that Congress acted constitutionally when it passed the statute.[571] And, as discussed above, we believe that the changes made in the final rule mitigate the concern that the rule compels speech that may be false or unfairly stigmatizing for some issuers. The requirement that issuers that know or have reason to believe that their conflict minerals may have originated in the Covered Countries but that cannot determine the origin or cannot determine whether they financed or benefited armed groups state that their products have not been found to be

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[571] See Nebraska v. EPA, 331 F.3d 995, 997 (D.C. Cir. 2003) ("Agencies do not ordinarily have jurisdiction to pass on the constitutionality of federal statutes.") (citing Thunder Basin Coal Co. v. Reich, 510 U.S. 200, 215 (1994)); Todd v. SEC, 137 F.2d 475, 478 (6th Cir. 1943) (same); William J. Haberman, 53 S.E.C. 1024, 1029 n.14 (1998) ("[W]e have no power to invalidate the very statutes that Congress has directed us to enforce.") (citing Milton J. Wallace, 45 S.E.C. 694, 697 (1975); Walston & Co., 5 S.E.C. 112, 113 (1939)).

"DRC conflict free" compels an accurate disclosure in light of the statutory definition of "DRC conflict free." Moreover, the use of this revised language, the ability of issuers to add additional explanation and disclosure, and the provision of a temporary "undeterminable" period all represent accommodations to ensure that the rule is appropriately tailored to lessen the impact on First Amendment interests while still accomplishing Congress's objective.

We note that many commentators appeared to believe that the proposed rules would require that an issuer physically label its products as "DRC conflict free" or not "DRC conflict free."[572] Although we used the term "label" in the Proposing Release, we did so in the context of the disclosure required in the annual report. The final rule does not require a physical label on any product. Instead, the final rule requires that an issuer describe in its Conflict Minerals Reports any products that have not been found to be "DRC conflict free," as defined in the final rule. Also, consistent with the proposal, the final rule permits issuers the flexibility to describe their products based on each issuer's individual facts and circumstances. We believe this flexibility is important because, as one commentator noted, an issuer is in the best position to know its products and to describe them in terms commonly understood within its industry.[573] Also, to remedy any confusion in the Proposing Release, an issuer with products that are "DRC conflict free" does not have to describe those products in the Conflict Minerals Report in any manner. An issuer with such products may describe them in its specialized disclosure report as

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[572] See, e.g., letters from Howland; Industry Group Coalition I; Japanese Trade Associations, MSG I, NAM I, and SIF I.

[573] See letter from WGC II.

"DRC conflict free" if it chooses to do so, provided, the products do not contain any conflict minerals that directly or indirectly financed or benefited armed groups in the Covered Countries.

The Conflict Minerals Statutory Provision requires the State Department to "produce a map of mineral-rich zones, trade routes, and areas under the control of armed groups" in the Covered Countries.[574] Also, the Conflict Minerals Statutory Provision requires the State Department to submit to Congress a strategy to address the linkages between human rights abuses, armed groups, mining of conflict minerals, and commercial products that contains a "plan to provide guidance to commercial entities seeking to exercise due diligence on and formalize the origin and chain of custody of conflict minerals used in their products and on their suppliers to ensure that conflict minerals used in the products of such suppliers do not directly or indirectly finance armed conflict or result in labor or human rights violations."[575] Some commentators have suggested that we delay the implementation of the final rule until the State Department's map and/or strategy have been published,[576] or that we should allow an issuer to rely on the State Department's map for its conflict minerals information.[577]

The State Department has published a conflict minerals map already.[578] Also, we

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574 Section 1502(c)(2) of the Act.

575 Section 1502(c)(1) of the Act.

576 See, e.g., letters from Barrick Gold, Corporate Secretaries I, NRF I, and WGC II.

577 See, e.g., letters from AngloGold and NRF I.

578 See STATE DEPARTMENT, HUMANITARIAN INFORMATION UNIT, DEMOCRATIC REPUBLIC OF THE CONGO MINERAL EXPLOITATION BY ARMED GROUPS MAP (Jun. 14, 2011), available at https://hiu.state.gov/Products/DRC_MineralExploitation_2010Jun28_HIU_U182.pdf.

understand that the State Department has developed guidance for commercial entities seeking to exercise due diligence on and formalize the origin and chain of custody of conflict minerals used in their products and on their suppliers.[579] Even so, it does not appear that either the State Department's map or guidance is necessary for complying with the final rule. First, it does not appear that Congress intended that they be necessary to comply with our rule. The map and guidance requirements are located in a part of Section 1502 that is not incorporated into the Exchange Act and that part of Section 1502 is directed solely to agencies other than the Commission.[580] Therefore, although they may be related to our final rule, it does not appear that the map and guidance were intended to have direct impact on the rule.

Also, we do not believe that an issuer must rely solely on the State Department's map or guidance for determining whether its conflict minerals contributed to conflict in the Covered Countries because other resources are available. For example, as discussed above, the OECD has developed an internationally recognized system of due diligence that an issuer can use as guidance in exercising its due diligence. The OECD's due diligence guidance does not rely on or incorporate the State Department map and guidance referenced in the Conflict Minerals Statutory Provision in determining the steps an issuer must take to exercise due diligence. However, as discussed above, due to the stage of development of the supply chain tracing mechanisms, we recognize that there are

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[579] See STATE DEPARTMENT, BUREAU OF ECONOMIC, ENERGY, AND BUSINESS AFFAIRS, STATEMENT CONCERNING IMPLEMENTATION OF SECTION 1502 OF THE DODD-FRANK LEGISLATION CONCERNING CONFLICT MINERALS DUE DILIGENCE (July 15, 2011), available at http://www.state.gov/e/eb/diamonds/docs/168632.htm.

[580] The map and guidance requirements are in Section 1502(c) of the Act, but only Section 1502(b) of the Act actually amends the Exchange Act and directs the Commission to promulgate rules.

concerns about obtaining this information reliably in the near term. Therefore, we are providing this targeted and temporary period in the final rule.

The final rule requires, as proposed, an issuer with conflict minerals that originated in the Covered Countries to determine whether those minerals directly or indirectly financed or benefited armed groups in the Covered Countries. The Conflict Minerals Statutory Provision states that products are "DRC conflict free" when those products do not contain conflict minerals that "directly or indirectly finance or benefit armed groups" in the Covered Countries.[581] Section 1502(e)(3) of the Act defines the term "armed group" as "an armed group that is identified as perpetrators of serious human rights abuses in the annual Country Reports on Human Rights Practices under sections 116(d) and 502B(b) of the Foreign Assistance Act of 1961,"[582] as they relate to the Covered Countries.[583] The final rule includes, as proposed, a cross reference to that definition to provide guidance to issuers. This cross reference, however, removes the phrases "most recently issued" and "for the year the annual report is due" to address the concerns of commentators.[584] The final rule mirrors the Conflict Minerals Statutory Provision in its definition of "armed group" and does not include any extraneous phrases that were included in the proposal.

The Conflict Minerals Statutory Provision assigns to the State Department the authority to identify perpetrators of serious human rights abuses in that agency's annual

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[581] See Exchange Act Sections 13(p)(1)(A)(ii) and 13(p)(1)(D).

[582] 22 U.S.C. 2151n(d) and 2304(b).

[583] Section 1502(e)(3) of the Act.

[584] See, e.g., letters from ITRI I and TIC.

Country Reports, and we lack the authority and expertise to provide further guidance or qualify the State Department's conclusions in this area. We note that some commentators indicated that we should consider products containing conflict minerals obtained from mines not controlled by armed groups when purchased to be considered "DRC conflict free" even if those mines subsequently come under the control of armed groups.[585] We agree and consider products "DRC conflict free" if, when the conflict minerals contained in those products are purchased and transported through the supply chain from the mine to the issuer, those conflict minerals do not directly or indirectly finance or benefit armed groups in the Covered Countries, even if some point in that supply chain subsequently becomes controlled by an armed group. For example, if an issuer's conflict minerals are purchased from a mine that does not directly or indirectly finance or benefit armed groups in the Covered Countries when they are purchased, but the next day that mine is taken over by an armed group and the armed group takes the money previously provided to the miner from the issuer to purchase the conflict minerals that already left the mine, the products containing those conflict minerals may be considered "DRC conflict free," even though the money used to purchase the conflict minerals does, in fact, benefit that armed group subsequently.

### 2. Due Diligence Standard in the Conflict Minerals Report

We have interpreted the Conflict Minerals Statutory Provision as requiring an issuer to exercise due diligence based on the provision's requirement that an issuer describe the due diligence it exercised on the source and chain of custody of its conflict

[585] See, e.g., letters from AAEI, IPC I, and NRF I.

minerals.[586] In addition, the provision requires that an issuer include an independent private sector audit of the Conflict Minerals Report as a "critical component of due diligence."[587] Under Exchange Act Section 13(p)(1)(C), the Commission may determine an issuer's independent private sector audit or other due diligence processes to be unreliable and any Conflict Minerals Report that relies on such unreliable due diligence process would not satisfy the statute's reporting requirement.[588]

a. **Proposed Rules**

The proposed rules would have required an issuer to use due diligence regarding the supply chain determinations[589] in its Conflict Minerals Report. Other than requiring that the due diligence be reliable, the proposed rules would not have dictated the standard for, or otherwise provided guidance concerning, the due diligence that an issuer would be required to use in making such determinations. Instead, the proposed rules would have required an issuer to disclose the due diligence it used in making its determinations, such as whether it used any nationally or internationally recognized standards or guidance for supply chain due diligence.

In the Proposing Release, we noted our belief that the statutory provision contemplates that an issuer must use due diligence in its supply chain determinations.

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586 Exchange Act Section 13(p)(1)(A)(i).

587 Exchange Act Section 13(p)(1)(B).

588 Exchange Act Section 13(p)(1)(C).

589 We refer to the "supply chain determinations" as an issuer's determinations regarding the source and chain of custody of its conflict minerals, the facilities used to process those minerals, the country of origin of those minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity.

Although we did not propose to establish any particular conduct requirements, we believed that due diligence would be required to be exercised and information about what conduct the issuer exercised in its due diligence regarding its supply chain determinations was relevant to determine the extent of the issuer's due diligence. As proposed, the rules, therefore, would require issuers to describe the due diligence used in making these determinations. In particular, we noted that we would have expected that an issuer whose conduct conformed to a nationally or internationally recognized set of standards of, or guidance for, due diligence regarding its conflict minerals supply chain determinations would provide evidence that it used due diligence in making those determinations.

**b. Comments on the Proposed Rules**

Some commentators believed that the Conflict Minerals Statutory Provision expressly requires an issuer to exercise due diligence on the source and chain of custody of its conflict minerals.[590] One commentator noted that nothing in the statute gives us explicit authority to develop due diligence guidance.[591] Another commentator asserted that Congress intended the Conflict Minerals Statutory Provision to require due diligence only on the source and chain of custody of conflict minerals mined in the DRC and on the transportation routes through which such minerals pass in countries adjoining the

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[590] See, e.g., letters from NEI ("We agree that issuers should be required to use due diligence, as proposed."), Presbyterian Church USA (Feb. 15, 2012) ("Presbyterian Church I") (stating that the Conflict Minerals Statutory Provision "requires due diligence"), Sen. Durbin / Rep. McDermott (stating that "Section 1502 requires companies to exercise strict due diligence to determine the source of conflict minerals in their products"), and State II ("It is unclear how a reasonable conflict minerals determination can be made without due diligence given the complexity of the region and the risk of fraud.").

[591] See letter from TriQuint I. This commentator suggested that the Commission work with other government agencies to establish rules that govern what due diligence processes are reliable.

DRC.[592] This commentator claimed that Congress did not intend for the Conflict Minerals Statutory Provision to require due diligence on the source and chain of custody of minerals mined in the adjoining countries and recommended that the final rule not require such due diligence.

Many commentators supported our proposal to not prescribe any specific due diligence requirements and allow an issuer to have flexibility in developing its due diligence measures based on the issuer's own facts and circumstances.[593] A number of these commentators, however, suggested that the final rule provide guidance as to what would be considered acceptable due diligence.[594] Many other commentators recommended that the final rule provide a definition of or prescribe specific guidance for any required due diligence.[595] Some of these commentators reasoned that the final rule should prescribe a specific due diligence standard so that an issuer will be unable to "engage in a type of 'forum shopping'" for the least burdensome standard and so that each issuer's due diligence measures will be consistent, accurate, and reliable.[596] Other commentators suggested that the final rule should prescribe a safe harbor for an issuer's conduct allowing an issuer to avoid any undue or impractical requirements set forth by

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[592] See letter from Minister of Energy and Minerals of the United Republic of Tanzania (May 23, 2011) ("Tanzania II").

[593] See, e.g., letters from AAEI, AngloGold, Cleary Gottlieb, Industry Group Coalition Group I, IPC I, ITIC I, ITRI I, Japanese Trade Associations, NAM I, NEI, Niotan II, NMA II, NRF I, RILA, RILA-CERC, RMA, Roundtable, Sen. Durbin / Rep. McDermott, TriQuint I, and WGC II.

[594] See, e.g., letters from AAEI, Cleary Gottlieb, Earthworks, Howland, IPC I, ITIC I, ITRI I, NAM I, NEI, NMA II, NRF I, RILA, Sen. Durbin / Rep. McDermott, and WGC II.

[595] See, e.g., letters from Arkema, Earthworks, Enough Project I, CENCO I, CODSIA, Global Witness I, Howland, ICAR et al. II, Materials I, Andrew Matheson (Mar. 2, 2011) ("Matheson I"), MSG I, NYCBar I, Rep. Berman et al., SEMI, SIF I, State I, State II, and WGC et al. I.

[596] See letters from Global Witness I and ICAR et al. II.

independent private sector auditors.[597] While we did not propose to require satisfaction of a particular set of standards, we requested comment on whether we should.

A number of commentators suggested that the final rule should refer to, incorporate, or require the use of national or international standards or guidance in some manner, such as accepting an issuer's due diligence as reliable if that issuer used a national or international standard or guidance, considering national or international due diligence standards or guidance when developing the final rule, or requiring an issuer to use a national or international due diligence framework for that due diligence to be considered reliable.[598] Some commentators did not believe the final rule should require that an issuer use any particular national or international due diligence standard.[599] Other commentators recommended against incorporating voluntary international standards, such as the OECD due diligence framework, into the final rule or suggested that we identify and assess the potential latent risks and/or impacts to industry and auditors related to codifying voluntary industry standards, such as the OECD due diligence framework, into the final rule.[600] Some commentators specifically referenced the due diligence framework developed by the OECD in discussing what they believed the final

[597] See, e.g., letters from ArcelorMittal, Chamber I, ITIC I, Materials I, NAM I, NRF I, and RILA.

[598] See, e.g., letters from Arkema, CODSIA, Earthworks, Enough Project I, Global Witness I, Howland, ICAR et al. II, IPC I, ITIC I, ITRI I, Matheson I, MSG I, NEI, NYCBar I, Rep. Berman et al., SEMI, Sen. Durbin / Rep. McDermott, SIF I, State I, State II, WGC II, and WGC et al. I.

[599] See, e.g., letters from Cleary Gottlieb, NAM I, NMA II, and WGC II.

[600] See letters from Auditing Roundtable, Inc. (Oct. 31, 2011) ("ARI") and Board of Environmental, Health & Safety Auditor Certifications (Oct. 31, 2011) ("BEAC").

rule should consider as acceptable due diligence.[601] One commentator recommended that the final rule not only refer to the OECD due diligence framework, but also should require issuers to disclose the steps that they took to complete the OECD due diligence.[602]

Some commentators recommended that a due diligence standard should not require an absolute standard of care.[603] Instead, these commentators suggested either a "reasonable care" or a "commercially practicable efforts" standard that would encompass contractual obligations, risk-based programs, and industry-wide processes, but not necessarily include the identification of all the parties in the supply chain or the determination of every mineral used for manufactured items. Some commentators recommended that an issuer's due diligence should be presumed reliable if the issuer performs some or all of the following steps: uses information from an industry-wide process; creates a conflict minerals policy that requires conflict-mineral free provisions in all contracts, conducts supply chain risk assessments, requires suppliers to push policies upstream and transmit information downstream, establishes policies and procedures to remediate instances of non-conformity of policy, obtains independent third party audits, and publishes its supply chain findings.[604] Similarly, other commentators indicated that

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601 See, e.g., letters from Arkema, Boeing, CODSIA, Earthworks, Enough Project I, Evangelical Alliance, Evangelicals, Global Witness I, ICAR et al. II, ITRI I, ITRI IV, Matheson I, Methodist Board, MSG I, NEI, NYCBar I, NYCBar II, Presbyterian Church II, Rep. Berman et al., Sen. Durbin / Rep. McDermott, SEMI, SIF I, SIF II, State I, State II, and WGC II, and WGC et al. I.

602 See letter from SIF II.

603 See, e.g., letters from AAEI, Chamber I, CRS I, Industry Group Coalition I, ITIC I, and NAM I.

604 See, e.g., letters from AAEI, Global Witness I, Industry Coalition Group II, NAM I, and NRF I. These steps are similar to the steps in the Annex I of the OECD's due diligence guidance.

due diligence should be presumed reliable if these conditions are met, but only if the issuer requires upstream and downstream due diligence and describes that due diligence.[605] Other commentators suggested that the due diligence standard in the final rule should be commensurate with the issuer's position in the supply chain such that the due diligence requirement for an issuer would be less rigorous the farther that issuer's position in the supply chain is from the mine or other location of origin.[606]

In the Proposing Release, we requested comment as to whether the final rule should prescribe different due diligence measures for gold because of any unique characteristics of the gold supply chain. In response, most commentators that discussed this point agreed that the due diligence required for gold should be the same as the due diligence required for the other three conflict minerals.[607] Two commentators, however, stated that gold is unique among the four conflict minerals so the due diligence requirements for it should be different than for the other minerals.[608] As discussed above, a few commentators further recommended that the final rule permit issuers to exclude certain information from public dissemination regarding the storage and transportation routes of gold for security reasons.[609]

In the Proposing Release, we also requested comment as to whether the final rule

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[605] See, e.g., letters from Earthworks, Enough Project I, MSG I, and SIF I. The upstream and downstream due diligence that would be required by these commentators is similar to the upstream and downstream due diligence described in the Supplement on Tin, Tantalum, and Tungsten to the OECD's due diligence guidance.

[606] See letters from CERC, Chamber I, ITIC I, NRF I, and RILA.

[607] See, e.g., letters from Earthworks, Global Witness I, ITRI I, SIF I, and State II.

[608] See letters from AngloGold and WGC II.

[609] See letters from NMA II, NAM III, and WGC II.

should state that an issuer is permitted to rely on the reasonable representations of its smelters or any other actor in the supply chain, provided there is a reasonable basis to believe the representations of the smelters or other parities. A number of commentators suggested, in response, that the final rule should allow an issuer to rely on reasonable representations from suppliers and/or smelters in satisfying their due diligence requirement.[610] Some of these commentators, however, explained that such written representations must be accompanied by additional processes, such as industry-wide smelter verification programs, before they could be relied upon.[611] One commentator recommended that the final rule should allow due diligence to be satisfied if an issuer includes obligations in its supply contracts and receives reasonable representations from its suppliers regarding the conflict-free nature of the minerals.[612]

**c. Final Rule**

After considering the comments, we are revising the final rule. The final rule requires that an issuer describe the due diligence it exercised in determining the source and chain of custody of its conflict minerals. The final rule requires that an issuer's due diligence follow a nationally or internationally recognized due diligence framework. We are persuaded by commentators that requiring an issuer to use a nationally or

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[610] See, e.g., letters from AngloGold, Global Witness I, Howland, IPC I, ITIC I, Japanese Trade Associations, JVC et al. II, Kemet, NEI, NMA II, RILA-CERC, RMA, Roundtable, SEMI, Sen. Durbin / Rep. McDermott, State II, Taiwan Semi, and WGC II.

[611] See letters from Global Witness I, Howland, ITIC I, JVC et al. II (stating that written representations would not have to be accompanied by additional processes "until such time as reliable smelter/refiner certification and due diligence systems can be implemented"), Kemet, NMA II, RMA, Sen. Durbin / Rep. McDermott, and State II.

[612] See letter from Roundtable.

internationally recognized due diligence framework that is relevant to the audit objectives and permits consistent assessment of the subject matter will provide an independent private sector auditor with a structure by which to assess an issuer's due diligence, which we believe should make the rule more workable and less costly than if no framework was specified. We are also persuaded by commentators that requiring the use of nationally or internationally recognized due diligence framework will enhance the quality of an issuer's due diligence and will promote comparability of the Conflict Minerals Reports of different issuers. Also, we believe that requiring such due diligence will provide issuers with a degree of certainty and, as one commentator noted, "ameliorate the risk that a due diligence process will later be judged to be unreliable."[613]

The OECD's "Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas"[614] satisfies our criteria and may be used as a framework for purposes of satisfying the final rule's requirement that an issuer exercise due diligence in determining the source and chain of custody of its conflict minerals. As one commentator noted, the OECD is an international organization with 34 member countries, including the United States, that works internationally with governments and businesses and approved its due diligence guidance as the "the result of a collaborative initiative among governments, international organizations, civil society organizations, and industry participants to promote accountability and transparency in the

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[613] See letter from NAM I.

[614] OECD, DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS (2011), available at http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/46740847.pdf.

supply chain of minerals from conflict-affected and high-risk areas."[615] A comment letter submitted by the OECD in conjunction with the United Nations Group of Experts on the Democratic Republic of the Congo ("Group of Experts") and the International Conference on the Great Lakes Region ("ICGLR") indicated that the OECD due diligence guidance was "adopted as an OECD Recommendation by forty one OECD and non-OECD countries meeting at ministerial level on 25 May 2011 under the chairmanship of U.S. Secretary of State Hillary Rodham Clinton."[616] The final rule does not mandate that an issuer use any particular nationally or internationally recognized due diligence framework, such as the OECD's due diligence guidance, in recognition of the fact that other evaluation standards may develop that satisfy the intent of the Conflict Minerals Statutory Provision. However, to satisfy the requirements of the final rule, the nationally or internationally recognized due diligence framework used by the issuer must have been established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment, and be consistent with the criteria standards in GAGAS established by the GAO.

As a related matter, one commentator stated that the final rule should clarify whether an issuer has to describe generally its due diligence processes or whether issuers have to describe specifically purchase contracts associated with particular conflict minerals in their products.[617] We believe an issuer's description of its due diligence should be based on the individual issuer's facts and circumstances. In this regard, if an

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[615] See letter from Global Witness I.

[616] See letter from OECD I.

[617] See letter from ITIC I.

issuer's due diligence process is relatively consistent throughout its supply chain, the issuer could satisfy the requirements by generally describing its due diligence. We recognize, however, that an issuer may use different due diligence processes for different aspects of its supply chain. For example, an issuer using the OECD due diligence guidance may use different due diligence processes for tin, tantalum, and tungsten as compared with that for gold. If an issuer exercises significantly different due diligence processes for different aspects of its supply chain, such as with separate conflict minerals or products, that issuer should describe how they are different.

As we note above, a number of commentators recommended that the final rule allow an issuer to rely on reasonable representations from suppliers and/or smelters in satisfying their due diligence requirement,[618] whereas other commentators argued that written representations should not be able to satisfy due diligence by themselves.[619] The final rule requires that an issuer's due diligence follow a nationally or internationally recognized due diligence framework. Therefore, whether an issuer may rely on reasonable representations from suppliers and/or smelters in satisfying its due diligence requirement will be dependent on the nationally or internationally recognized due diligence framework.

### 3. Independent Private Sector Audit Requirements

#### a. Proposed Rules

Consistent with the Conflict Minerals Statutory Provision, we proposed that the

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618 See, e.g., letters from AngloGold, Global Witness I, Howland, IPC I, ITIC I, Japanese Trade Associations, JVC et al. II, NEI, NMA II, RILA-CERC, RMA, SEMI, State II, Taiwan Semi, and WGC II.

619 See letters from Global Witness I, Howland, ITIC I, and RMA.

description of the measures taken by an issuer to exercise due diligence on the source and chain of custody of its conflict minerals include a certified independent private sector audit conducted in accordance with the standards established by the Comptroller General of the United States.[620] Under the Conflict Minerals Statutory Provision, the GAO is to establish the appropriate standards for the independent private sector audit. Therefore, we did not include any auditing standards in the proposed rules or discuss such standards in the Proposing Release.

**b. Comments on the Proposed Rules**

A number of commentators indicated that the final rule must clarify the independent private sector audit's criteria, objectives, and standards.[621] One commentator was concerned that, if neither the Comptroller General nor the Commission required uniform objectives and standards, the audits would not be useful because they would lack any comparability.[622] Some commentators remarked that the Comptroller General or the Commission must delineate suitable criteria for the measurement and presentation of the information in the Conflict Minerals Report, including the elements of the Conflict Minerals Report subject to the audit, so as to provide an audit framework that

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[620] See Exchange Act Section 13(p)(1)(A)(i).

[621] See, e.g., letters from American Institute of Certified Public Accountants (Mar. 1, 2011) ("AICPA I"), American Institute of Certified Public Accountants (Nov. 17, 2011) ("AICPA II"), Barrick Gold, BEAC, Calvert, Deloitte, The Elm Consulting Group International LLC (Mar. 1, 2011) ("Elm"), Ernst & Young, LLP (Mar. 2, 2011) ("E&Y"), Grant Thornton (recommending that the Commission establish a "working group to support the Comptroller General in the development of the appropriate form of engagement, including the criteria to be used to evaluate the subject matter and the opinion (or conclusion) to be expressed thereon"), Hileman Consulting, ICGLR, IPC II, KPMG LLP (Mar. 2, 2011) ("KPMG"), MSG III, NEI, NYCBar I, WGC II.

[622] See letter from WGC II.

would aid both issuers and auditors.[623] Such criteria would provide the basis for the auditor to measure the information provided by the issuer, and this criteria should be objective, measurable, complete, and relevant.[624] Commentators noted, however, that the criteria would differ based on the objective of the audit. For example, the criteria for evaluating whether an issuer is correct in concluding that its products are "DRC conflict free" are different from the criteria for determining whether the issuer's process for determining whether its products are "DRC conflict free" is sufficient.[625]

Commentators from the accounting profession and others recommended that the final rule clearly state the objective of the audit and the subject matter to be audited.[626] Some of these commentators identified possible audit objectives, including: whether management's description of the procedures and controls performed in an issuer's due diligence process are fairly described in the Conflict Minerals Report;[627] whether the design of an issuer's due diligence process described in the Conflict Minerals Report conforms to a recognized standard of due diligence;[628] whether management's description of an issuer's due diligence process in its Conflict Minerals Report is accurate, the results of that process are fairly stated, and the issuer has evaluated/identified the upstream and

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623 See, e.g., letters from Deloitte and KPMG.

624 See letters from Deloitte and Grant Thornton.

625 See letters from AICPA I and Grant Thornton.

626 See letters from AICPA I, AICPA II, Barrick Gold, Grant Thornton, IPC II, KPMG, MSG III, and SIF II.

627 See letters from AICPA I, AICPA II, Grant Thornton, and KPMG.

628 See letters from AICPA I, AICPA II, IPC II, and KPMG. Commentators also observed that this second objective would require the final rule to provide a clear due diligence standard against which an auditor could compare the issuer's due diligence process.

downstream due diligence processes;[629] whether the design of the due diligence process described in the Conflict Minerals Report conforms to a recognized a standard and whether the process was sufficiently effective;[630] whether the issuer's conclusion regarding the source and chain of custody of its conflict minerals is accurate;[631] and whether the issuer appropriately included in the report all its products described as not "DRC conflict free."[632] Generally, commentators recommended that the final rule not require an audit objective to include a determination as to whether an issuer's due diligence process was effective or that any conclusion based on that due diligence process was accurate, because that would be very challenging and expensive to undertake.[633]

Additionally, some commentators indicated that the Comptroller General or the Commission must identify the acceptable auditing standards for firms to use when auditing an issuer's Conflict Minerals Report.[634] In this regard, as some commentators noted,[635] the Proposing Release stated that the staff of the GAO informed our staff of its preliminary view that no new audit standards need to be promulgated. Therefore, the audit of the Conflict Minerals Report would be performed under GAGAS, and auditors

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629 See letter from MSG III (noting, however, that the audit scope should not include verification of the ultimate conclusions of the Conflict Minerals Report, only that the process was applied as described). See also letter from SIF II (stating that the audit of the Conflict Minerals Report should include a "review of management systems and processes, and of conclusions reached").

630 See letter from AICPA I.

631 See letters from AICPA I and KPMG.

632 See id.

633 See, e.g., letters from AICPA I, AICPA II, Deloitte, ITIC I, KPMG, MSG III, and Roundtable.

634 See letters from AICPA I, Deloitte, E&Y, Elm, and KPMG.

635 See, e.g., letters from Barrick Gold and E&Y.

could use either the provisions for Attestation Engagements or Performance Audits in GAGAS.[636] However, as commentators noted, in addition to certain substantive differences between the two standards in GAGAS, only a licensed certified public accountant or person working with a certified public accounting firm or governmental auditing organization may perform an Attestation Engagement.[637] Similarly, commentators noted that Performance Audits are not required to be conducted by certified public accountants, but auditors using the Performance Audit standard would still need to satisfy certain qualification requirements under GAGAS, such as continuing professional education requirements, quality control measures, and independent peer reviews.[638] In this regard, to increase the pool of auditors and thereby reduce costs, some commentators recommended that the final rule allow auditors to use the Performance Audit standard under GAGAS.[639] Some of these commentators recommended that auditors that are not certified public accountants could satisfy GAGAS's Performance Audit qualification requirements by receiving a professional certification relating to environmental, health, and safety auditing from organizations that certify auditors by requiring that an auditor meet certain standards, such as having a code of conduct, committing to a code of ethics and rigorous practices, engaging in continuing professional development and education, being subjected to review, and other provisions

[636] See letters from AICPA I, AICPA II, BEAC, Deloitte, E&Y, Elm, Grant Thornton, and MSG III.

[637] See, e.g., letters from AICPA I and BEAC.

[638] See letter from Deloitte and BEAC.

[639] See, e.g., letters from ArcelorMittal, ARI, BEAC, Hileman Consulting, IPC II, and MSG III.

to maintain a high caliber of expertise.[640] One commentator suggested that the final rule should allow any auditor to perform the audit as long as it was knowledgeable and able to meet the requirements of the OECD's criteria for the competence of auditors.[641] Other commentators noted, however, that the OECD's criteria for the competence of auditors are inadequate because they fail to provide any guidance as to how this would be assured.[642] Another commentator recommended that the final rule should delineate specific requirements for the accreditation and selection of auditors but did not provide any suggested requirements.[643]

Several commentators asserted that the final rule should clarify the independence standards for auditors.[644] Some of these commentators[645] recommended that the final rule state that performing the independent private sector audit of the Conflict Minerals Report is not inconsistent with the Commission's auditor independence requirements in Rule 2-01 of Regulation S-X.[646] One commentator noted, however, that the OECD's independence requirements prohibit a Conflict Minerals Report auditor from having provided any other service for the issuer within a 24-month period.[647] Similarly, two other commentators asserted that the statement in the proposed rules and the Conflict

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640 See letters from BEAC and Hileman Consulting.

641 See letter from NYCBar I.

642 See letter from ARI and BEAC.

643 See letter from ICGLR.

644 See, e.g., letters from AICPA I, Deloitte, E&Y, Grant Thornton, Hileman Consulting, and KPMG.

645 See letters from AICPA I, Deloitte, and E&Y.

646 17 CFR 210.2-01.

647 See letter from KPMG.

Minerals Statutory Provision that the independent private sector audit would be considered a "critical component of due diligence" could create confusion regarding the application of our auditor independence requirements in Rule 2-01 of Regulation S-X.[648]

### c. Final Rule

#### i. Auditing Standards

As noted above, the GAO staff has indicated to our staff that the GAO does not intend to develop new standards for the independent private sector audit of the Conflict Minerals Report. As we noted in the Proposing Release, GAO staff informed our staff that existing GAGAS standards,[649] such as the standards for Attestation Engagements or the standards for Performance Audits will be applicable.[650] The GAO staff has also indicated to our staff that the GAGAS Performance Standards could be used by the auditor to express a conclusion as to whether the design of the issuer's due diligence measures are in conformity with the criteria set forth in a nationally or internationally recognized due diligence framework used by the issuer, such as the OECD's "Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas," and whether the issuer's description of the due diligence measures it performed, as set forth in the Conflict Minerals Report, with respect to the period

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648 See letters from E&Y and Grant Thornton.

649 See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-331G, GOVERNMENT AUDITING STANDARDS 2011 REVISION (Dec. 2011), available at http://www.gao.gov/assets/590/587281.pdf.

650 The GAGAS Attestation Engagement standards, in Chapter 3.75, require that auditors be "licensed certified public accountants, persons working for a licensed certified public accounting firm or for a government auditing organization, or licensed accountants in states that have multi-class licensing systems that recognize licensed accountants other than certified public accountants." Unlike the GAGAS Attestation Engagement standards, the GAGAS Performance Audit standards allow auditors other than certified public accountants to perform a Performance Audit.

covered by the report, is consistent with the due diligence process that the issuer undertook. Therefore, unless the GAO makes some formal pronouncement, it appears that any auditor of the Conflict Minerals Report will need to conduct the audit using the standards set forth in GAGAS. Because the Conflict Minerals Statutory Provision provides that the audit standards are to be established by the GAO, the GAO is responsible for matters pertaining to the audit standards, including questions or concerns about the application of such standards.

**ii. Auditor Independence**

Similarly, entities performing an independent private sector audit of the Conflict Minerals Report must comply with any independence standards established by the GAO, and any questions regarding applicability of GAGAS on this point should be directed to the GAO. We are not adopting any additional independence requirements. Also, the independence required for the independent private sector audit of the Conflict Minerals Report is not the same as the OECD's independence requirement for auditors conducting audits of conflict mineral smelters.

We acknowledge commentators' requests to clarify how our own independence requirements would apply to an accountant that performed both the independent private sector audit of the Conflict Minerals Report and an engagement (e.g., the audit of the financial statements of an issuer) subject to the independence requirements in Rule 2-01 of Regulation S-X.[651] The independent private sector audit of the Conflict Minerals Report is specifically described in the Act as constituting a "critical component" of the

[651] Rule 2-01 of Regulation S-X [17 CFR 210.2-01].

registrant's due diligence process,[652] which commentators were concerned may suggest the auditor would perform work that would impair independence. Despite this language, the Conflict Minerals Statutory Provision only requires an audit and no other functions that may imperil independence, such as "management functions" described in Rule 2-01(c)(4)(vi) of Regulation S-X. Therefore, we do not believe that it would be inconsistent with the independence requirements in Rule 2-01 of Regulation S-X if the independent public accountant also performs the independent private sector audit of the Conflict Minerals Report. The engagement to perform the independent private sector audit of the Conflict Minerals Report would nevertheless be considered a "non-audit service" subject to the pre-approval requirements of Rule 2-01(c)(7) of Regulation S-X. In addition, the fees related to the independent private sector audit of the Conflict Minerals Report would need to be included in the "All Other Fees" category of the principal accountant fee disclosures.[653] If the accountant were to provide services that extended beyond the scope of the independent private sector audit of the Conflict Minerals Report, the accountant would need to consider whether those services were inconsistent with Rule 2-01 of Regulation S-X.

**iii. Audit Objective**

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[652] Exchange Act Section 13(p)(1)(A)(i), as added by Section 1502 of the Act, states that the independent private sector audit of the conflict minerals report is included in the "measures taken by the [issuer] to exercise due diligence on the source and chain of custody of such minerals." Exchange Act Section 13(p)(1)(B) further provides that the audit must be certified by the issuer and states that the certified audit "is a critical component of due diligence in establishing the source and chain of custody of such minerals." These provisions make clear that the independent private sector audit is one step in management's due diligence process.

[653] See Item 9(e)(4) of Schedule 14A [17 CFR 240.14a-101]. Registrants also are required to describe the nature of the services comprising the fees disclosed under the "All Other Fees" category. As such, the independent private sector audit of the Conflict Mineral Report should be included in that description.

We agree with commentators that the final rule should clearly state the objective of the Conflict Minerals Statutory Provision's independent private sector audit and the subject matter to be audited to provide a basis for the auditor to measure the information provided by the issuer. Therefore, the final rule specifies an audit objective. The final rule states that the audit's objective is to express an opinion or conclusion as to whether the design of the issuer's due diligence framework as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is in conformity with, in all material respects, the criteria set forth in the nationally or internationally recognized due diligence framework used by the issuer, and whether the issuer's description of the due diligence measures it performed as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is consistent with the due diligence process that the issuer undertook.

The Conflict Minerals Statutory Provision requires an issuer to submit a Conflict Mineral Report that includes "a description of the measures taken by the [issuer] to exercise due diligence on the source and chain of custody of its conflict minerals, which measurers shall include an independent private sector audit of such report,"[654] and "a description of the products manufactured or contracted to be manufactured that are not DRC conflict free."[655] We recognize that the final rule does not require an audit of the entire Conflict Minerals Report. We believe, however, that it is appropriate for the final rule to limit the audit only to the sections of the Conflict Minerals Report that discuss the

[654] Exchange Act Section 13(p)(1)(A)(i).

[655] Exchange Act Section 13(p)(1)(A)(ii).

design of the issuer's due diligence framework and the due diligence measures the issuer performed because the provision's requirement for an issuer to obtain an independent private sector audit is located in the provision's subsection relating to due diligence.[656]

The audit requirement is not discussed in the subsequent subsection that requires a description in the Conflict Minerals Report of the issuer's products manufactured or contracted to be manufactured that are "not DRC conflict free,"[657] and the final rule does not require an audit of that information. We note that the objective we are adopting differs significantly from the objectives of other audits required by our rules.[658] Nonetheless, in light of the statutory structure, as well as concerns about the costs that could arise from a requirement to audit the conclusion about the conflict minerals' status or take other approaches,[659] we have concluded that the audit objective should be limited in this manner. We recognize that an audit objective requiring an auditor to express an opinion or conclusion as to whether the design of the issuer's due diligence measures as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is in conformity with, in all material respects, the criteria set forth in the nationally or

656 See Exchange Act Section 13(p)(1)(A)(i).

657 See Exchange Act Section 13(p)(1)(A)(ii).

658 The objective of the ordinary audit of financial statements by the independent auditor is the expression of an opinion on the fairness with which they present, in all material respects, financial position, results of operations, and its cash flows in conformity with generally accepted accounting principles. See paragraph .01 of AU sec. 110, Responsibilities and Functions of the Independent Auditor. The auditor's objective in an audit of internal control over financial reporting is to express an opinion on the effectiveness of the company's internal control over financial reporting, as a part of which the auditor should test the design effectiveness of controls, as well as the operating effectiveness of controls. See paragraphs 3, 42, and 44 of Auditing Standard No. 5, An Audit of Internal Control over Financial Reporting That Is Integrated With An Audit of Financial Statements.

659 See, e.g., letters from AICPA I, Deloitte, and KPMG.

internationally recognized due diligence framework used by the issuer, and whether the issuer's description of the due diligence measures it performed as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is consistent with the due diligence process that the issuer undertook, is not as comprehensive as an audit objective requiring an auditor to express an opinion or conclusion as to whether the due diligence measures were effective, or to express an opinion or conclusion as to whether or not the issuer's necessary conflict minerals are "DRC conflict free," which are more similar to audit objectives in our other rules. However, we believe that the audit is still meaningful because investors and other users will have some assurance from an independent third party that the issuer's due diligence framework, as set forth in the Conflict Minerals Report, is designed in conformity with the relevant nationally or internationally recognized due diligence framework. Further, we believe it is necessary and appropriate to require the audit to address whether the issuer actually performed the due diligence measures that it represents that it performed in the Conflict Minerals Report, so that the audit also addresses, in a cost efficient manner, the actual performance of the due diligence and not just the design, as well as provides independent third party confirmation that the work described was performed.

### 4. Recycled and Scrap Minerals

#### a. Proposed Rules

As proposed, the rules would allow for different treatment of conflict minerals from recycled and scrap sources than from original sources due to the difficulty of looking through the recycling or scrap process to determine the mine or other location of origin of the minerals. Given this difficulty, we expected that an issuer generally would not know the origins of its recycled or scrap conflict minerals, so we believed it would be appropriate for the proposed rules to require that an issuer using recycled or scrap conflict minerals furnish a Conflict Minerals Report subject to special rules. Under the proposed rules, if an issuer obtained conflict minerals from a recycled or scrap source, it would have been required to consider the products containing or produced with those conflict minerals to be "DRC conflict free."[660]

As proposed, an issuer with conflict minerals that originated from recycled or scrap sources would have been required to disclose in its annual report, under the "Conflict Minerals Disclosure" heading, that its conflict minerals were obtained from recycled or scrap sources and that it furnished a Conflict Minerals Report regarding those recycled or scrap minerals. Also, under the proposed rules, an issuer would have been required to state that its products containing or produced with recycled or scrap minerals in the Conflict Minerals Report were considered "DRC conflict free." In addition, such an issuer would have described the measures taken to exercise due diligence in determining that its conflict minerals were recycled or scrap and obtain an independent private sector audit of that report.

We did not propose to define when a conflict mineral is from recycled or scrap sources. Instead, any issuer seeking to use this alternative approach would describe the measures it took to exercise due diligence in determining that the conflict minerals came

[660] Because the proposed rules would have automatically classified recycled or scrap conflict minerals as "DRC conflict free," issuers with products containing such minerals would not have needed to provide in the Conflict Minerals Report a description of the recycled or scrap conflict minerals' processing facilities or country of origin, nor would they have been required to describe their efforts to determine the mine or location of origin with the greatest possible specificity.

from recycled or scrap sources. The Proposing Release stated, however, that we would consider conflict minerals to be "recycled" if they are reclaimed end-user or post-consumer products, but we would not consider those minerals "recycled" if they are partially processed, unprocessed, or a byproduct from another ore.[661]

b. Comments on the Proposed Rules

Commentators offered a wide variety of views on the appropriate approach to conflict minerals from recycled or scrap sources. A number of commentators stated that they either agreed with the recycled and scrap alternative reporting requirements, as proposed, or agreed with some type of recycled and scrap alternative reporting requirements or exemption, although some of these commentators did not necessarily discuss the mechanics of such reporting alternatives.[662] Some commentators indicated that they supported, as proposed, alternative recycled or scrap reporting that requires an issuer to perform due diligence in determining that the conflict minerals were, in fact,

[661] As we noted in the Proposing Release, the proposed rules regarding recycled and scrap conflict minerals would apply to all conflict minerals equally. If recycled or scrap minerals were mixed with new minerals, the recycled and scrap alternative approach would apply to only the portion of the minerals that were recycled or scrap and the issuer would be required to furnish a Conflict Minerals Report regarding at least the recycled or scrap minerals. If the issuer's new conflict minerals did not originate in the Covered Countries, that Conflict Minerals Report would contain only information regarding the recycled or scrap minerals. If, however, the new conflict minerals originated in the Covered Countries, or the issuer was unable to determine that its new conflict minerals did not originate in the Covered Countries, the Conflict Minerals Report would include information regarding both the new conflict minerals and the recycled or scrap conflict minerals.

[662] See, e.g., letters from AAEI, AAFA, CRS I, Global Tungsten I, Global Witness I, Japanese Trade Associations, MSC I, NRF I, Ohio Precious Metals (Mar. 2, 2011) ("OPM"), PCP, Representative Jason Altmire (Mar. 23, 2012) ("Rep. Altmire"), Rep. Amodei, Rep. Bachus et al., Rep. Critz, Rep. Ellmers, Representative Steven LaTourette (Jun. 13, 2012) ("Rep. LaTourette"), Representative Robert E. Latta (May 16, 2012) ("Rep. Latta"), Rep. Murphy, Representatives Tim Murphy and Peter J. Visclosky (Aug. 2, 2012) ("Reps. Murphy and Visclosky"), Representative James B. Renacci (Mar. 6, 2012) ("Rep. Renacci"), Representative Bill Shuster (Mar. 12, 2012) ("Rep. Shuster"), Representative Patrick J. Toomey (Apr. 12, 2012) ("Rep. Toomey"), Representative Stephen A. Womack (Dec. 23, 2011) ("Rep. Womack"), RMA, SEMI, Senator Mark Pryor (Mar. 19, 2012) ("Sen. Pryor"), and US Steel.

from recycled and scrap sources and to submit a Conflict Minerals Report describing the due diligence exercised that includes an audit of the report.[663] A number of commentators believed that the final rule should require that an issuer only conduct the equivalent of a reasonable country of origin inquiry, instead of due diligence, to determine whether its conflict minerals were from recycled or scrap sources.[664] Also, some of these and other commentators stated explicitly that an issuer should not be required to submit a Conflict Minerals Report and/or an audit of its recycled or scrap conflict minerals.[665] Other commentators, including a number of members of Congress, recommended that the final rule exempt conflict minerals from recycled or scrap sources.[666]

Other commentators stated that the final rule should require due diligence but not a Conflict Minerals Report, not require a Conflict Minerals Report but require an audit of the inquiry into whether the conflict minerals are from recycled or scrap sources, require a "reliable process" to determine whether the conflict minerals are from recycled or scrap

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663 See, e.g., letters from Bario-Neal, Brilliant Earth, Earthworks, Enough Project I, Enough Project IV, Hacker Jewelers, ICAR et al. II, Howland, SIF I, and TIAA-CREF.

664 See, e.g., letters from AdvaMed I, Advanced Medical Technology Association (Nov. 1, 2011) ("AdvaMed II"), AngloGold, Global Tungsten II, Industry Group Coalition I, ITIC I, ITRI I, ITRI IV, JVC et al. II, LBMA I, Metalor Technologies USA (Feb. 25, 2011) ("Metalor"), NMA I, RJC I, United States Chamber of Commerce (Nov. 29, 2011) ("Chamber III"), and WGC II.

665 See, e.g., letters from AdvaMed I, AdvaMed II, ArcelorMittal, Copper & Brass Fabricators Council, Inc. (Mar. 2, 2011) ("Copper & Brass"), Global Tungsten II, IPC I, IPC II, ITIC I, ITRI I, ITRI III, ITRI IV, JVC et al. II, JVC et al. III, Materials I, NAM I, Rep. Altmire, Rep. Amodei, Rep. Bachus et al., Rep. Ellmers, Rep. Murphy, Rep. Shuster, Sen. Pryor, Specialty Steel Industry of North America (Mar. 2, 2011) ("SSINA"), Tiffany, and WGC II. See also letter from Rep. Critz (stating that we should consider "reconfiguring the auditing requirement as it relates to recycled scrap materials").

666 See, e.g., letters from Rep. Altmire, Rep. Murphy, Reps. Murphy and Visclosky (recommending exempting recycled or scrap steel that contains conflict minerals), Rep. Renacci, Rep. Shuster, Rep. Toomey, Rep. Womack, and Sen. Pryor.

sources, or not require that an issuer provide any information other than a statement that the conflict minerals are from recycled or scrap sources.[667] Some commentators agreed that products with conflict minerals from recycled and scrap sources should be considered "DRC conflict free," as proposed.[668] Other commentators indicated that the final rule should require an issuer with products containing conflict minerals from recycled or scrap sources to label those products with a name other than "DRC conflict free," such as "recycled" or "scrap" products.[669]

Some commentators stated that the more the alternative reporting approach for conflict minerals from recycled or scrap sources resembles our approach for newly mined conflict minerals the greater the risk of creating a disincentive for manufacturers to use conflict minerals from recycled or scrap sources.[670] As one of these commentators asserted, without certain alternative reporting requirements for issuers with conflict minerals from recycled or scrap sources, such minerals "would be doomed for burial in a land fill until mined anew under a different authority having jurisdiction," which would be a "clear waste" of conflict minerals that "cannot contribute to new suffering in the DRC even though its disposition regarding past suffering may not be clear."[671] According to this commentator, "it is possible that dishonest people may find a way to pass new material off as recycled," but this possibility "does not outweigh the very

[667] See, e.g., letters from Cleary Gottlieb, JVC et al. II, MSG I, and NEI.

[668] See, e.g., letters from Copper & Brass, JVC et al. II, MSG I, NEI, NMA II, SIF I, SSINA, TIAA-CREF, and WGC II.

[669] See, e.g., letters from CRS I, Global Witness I, and State II.

[670] See, e.g., letters from Copper & Bass, Global Tungsten I, RMA, SEMI, and SSINA.

[671] See letter from SEMI.

obvious benefit of using recycled products and materials."[672] In this regard, other commentators argued that requiring issuers to provide the reason they determined that their conflict minerals came from recycled or scrap sources, including the due diligence processes they used in making their determination, would offset the reduced burden provided by the exemption.[673]

One commentator suggested that an issuer should be able to describe a product as using recycled or scrap minerals if a majority of the minerals used in the product are from recycled or scrap sources or a combination of recycled, scrap, and newly mined conflict minerals because it would be impossible to determine whether all the minerals in a product were from recycled or scrap sources.[674] Another commentator recommended that the final rule should allow an issuer to describe its products as "DRC conflict free" if a majority of the conflict minerals in those products are from recycled or scrap sources.[675] One commentator asserted that tolled material (scrap, second life-cycle materials, or ores processed into raw materials suitable for use in the manufacture of products) received from processing facilities or suppliers should be treated as conflict free if the original material supplied was conflict free.[676] A number of other commentators suggested that the final rule allow an issuer to designate the origin of any recycled or scrap conflict minerals as the country in which those minerals were generated and collected or

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672 See id.

673 See letters from Rep. LaTourette and Rep. Latta.

674 See letter from AngloGold.

675 See letter from WGC II.

676 See letter from Global Tungsten II.

otherwise initially submitted into the recycling or scrap supply chain, which is consistent with the United States customs law.[677] Also, commentators agreed that the alternative reporting requirements for recycled and scrap minerals should apply to all conflict minerals and issuers equally.[678]

Many commentators discussed the Proposing Release's statement that we would consider conflict minerals to be from a recycled or scrap sources if those minerals are reclaimed end-user or post-consumer products but would not consider those minerals "recycled" if they are partially processed, unprocessed, or a byproduct from another ore. Some of these commentators recommended that the final rule expand this statement to match the OECD's definition of recycled and scrap minerals or explicitly adopt the OECD's definition in the final rule.[679] Likewise, certain commentators recommended that the final rule clarify that we would consider conflict minerals from recycled or scrap sources to include scrap processed metals created during product manufacturing, which is part of the OECD definition.[680] These commentators, however, were concerned that the Proposing Release did not consider partially processed materials as being recycled, because they believed that such a definition would exclude industrial scrap, sometimes referred to as "new" scrap, generated by downstream manufacturers from the treatment given to recycled minerals.[681]

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[677] See, e.g., letters from IPMI I, LBMA I, Metalor, NMA II, and RJC I.

[678] See, e.g., letters from Howland, IPC I, ITRI I, and NEI.

[679] See, e.g., letters from Global Witness I, MSG I, and SIF I.

[680] See, e.g., letters from Copper & Brass and SSINA.

[681] Id.

Some commentators provided alternative definitions for recycled and scrap minerals. One commentator stated that the final rule should define a recycled or scrap conflict mineral as "a conflict mineral or a conflict mineral derivative that is within, or has been reclaimed from, a used product that was collected directly from the last product end user, or that was collected from a municipal waste stream."[682] Other commentators indicated that conflict minerals should be considered recycled or scrap only if they have been through a cycle of production and application.[683] A further commentator suggested that the final rule adopt, in substantial part, the Environmental Protection Agency's definition of solid waste for our definition of conflict minerals from recycled or scrap sources, with the related exclusions and definitions of various scrap materials.[684] One commentator recommended that we incorporate the Electronic Industry Citizenship Coalition's ("EICC") definition of "scrap" for tantalum as the definition for scrap in the final rule.[685] Certain commentators sought to limit the definition of recycled and scrap minerals to 100% post-consumer metals.[686] Some commentators suggested a definition that would include reclaimed materials from the manufacture of downstream products that incorporate those metals, processes utilizing those metals, or end-user or post-consumer products, which would not include minerals partially processed, materials from

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[682] See letter from SEMI (defining a "used product" as "a product that, prior to recycling or disposal, is commercially sold or otherwise distributed to a buyer not in the commercial chain of distribution and used for some period of time").

[683] See letters from Global Tungsten I and RMA.

[684] See letter from Elm.

[685] See letter from H.C. Starck GmbH (Jul. 27, 2011) ("Starck").

[686] See, e.g., letters from Bario-Neal, Brilliant Earth, Earthworks, Metalsmiths, Hacker Jewelers, and TakeBack.

the partially processed minerals, or materials from intermediate stages of the smelting and refining process.[687] One commentator recommended that the final rule consider as conflict minerals from recycled or scrap sources, "not only…post-consumer scrap, but also…scrap that is the result of an industrial process."[688]

Additionally, some commentators provided recommendations specifically for treating conflict minerals in jewelry, coins, and bars as recycled or scrap. One such commentator stated that conflict minerals from discarded consumer jewelry should be considered recycled or scrap.[689] Another commentator argued that any definition of recycled and scrap gold should grandfather gold bars and gold coins produced before the effective date of the final rule and exclude sludges, slimes, flue dust, carbon fines, slag, and other by-products from consideration as conflict minerals.[690] Conversely, other commentators stated that the definition of conflict minerals from recycled or scrap sources should include only those conflict minerals from post-consumer products and not include any jewelry unsold or not previously owned as end-use products by consumers.[691] Also, some of these commentators indicated that gold coins and bars should not be classified as recycled or scrap[692] because, as some of these commentators stated, they do

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687 See letters from ITRI I, JGI, and Solutions.

688 See letter from ArcelorMittal.

689 See letter from JVC et al. II.

690 See letter from NMA II.

691 See, e.g., letters from Brilliant Earth, Bario-Neal, Earthworks, Enough Project I, Hacker Jewelers, ICAR et al. II, and TakeBack

692 See, e.g., letters from Brilliant Earth, Bario-Neal, Enough Project I, Hacker Jewelers, ICAR et al. II, and TakeBack.

not represent a clear consumer end-of-life product and are less identifiable as not newly-mined gold.[693]

### c. Final Rule

We are revising the proposal's treatment of conflict minerals from recycled and scrap sources in the final rule. We agree with commentators that it is appropriate to provide alternative treatment for such conflict minerals so that the final rule does not provide a disincentive for using conflict minerals from recycled and scrap sources. However, we also want to include safeguards to prevent issuers from claiming to use conflict minerals from recycled and scrap sources when that is not the case. We believe, as certain commentators noted,[694] requiring an issuer with necessary conflict minerals to conduct an inquiry similar to the reasonable country of origin inquiry to determine whether its minerals are from recycled or scrap sources is an appropriate way to balance these concerns.[695] Under the final rule, if an issuer has reason to believe, as a result of its reasonable country of origin inquiry, that its conflict minerals may not have been from recycled or scrap sources, it must exercise due diligence. The issuer would then be required to provide a Conflict Minerals Report if it is unable to determine that the conflict minerals came from recycled or scrap sources.

We believe this approach for any issuer with conflict minerals from recycled or

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[693] See letter from Enough Project I and ICAR et al. II.

[694] See, e.g., letters from AdvaMed I, AdvaMed II, AngloGold, Global Tungsten II, Industry Group Coalition I, ITIC I, ITRI I, ITRI IV, JVC et al. II, LBMA I, Metalor, NMA I, RJC I, Chamber III, and WGC II.

[695] Because we envision these inquiries to be similar, we use the term "reasonable country of origin inquiry" to refer to an issuer's inquiry into both the conflict minerals' country of origin and whether the minerals are from recycled or scrap sources.

scrap sources is consistent with the Conflict Minerals Statutory Provision. The provision was intended to affect the "exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo [that] is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo."[696] As noted by some commentators, however, armed groups in the Covered Countries are financed and benefit from the extraction and illegal taxation of newly mined conflict minerals and their transport, not the use of recycled or scrap conflict minerals.[697] No further revenue or other benefit will be provided to the armed groups from any transaction involving the conflict minerals from recycled or scrap sources because the armed groups "have already extracted their revenue and do not stand to gain with [their] use or sale."[698]

In this regard, we believe it is appropriate, as proposed, to allow an issuer, if it wishes, to describe its products containing conflict minerals from recycled or scrap sources as "DRC conflict free." As one commentator explained, the "intent of the statute is to provide investors with information about whether minerals used in manufacturing

[696] See Section 1502(a) of the Act.

[697] See letters from AAEI and Global Tungsten I.

[698] See letter from AAEI. See letter from AAEI. See also OECD, OECD DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS, 7 n.2 (2011), available at http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/46740847.pdf (stating that metals "reasonably assumed to be recycled are excluded from the scope of this" guidance) and OECD, DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS: SUPPLEMENT ON GOLD, 28 n.34 (2012), available at http://www.oecd.org/corporate/guidelinesformultinationalenterprises/FINAL%20Supplement%20on%20Gold.pdf (stating that "[r]ecycled material is not itself a concern for contributing to conflict, however, recycled material is a potential means of laundering gold that has been mined in conflict-affected and high-risk areas in order to hide its origin").

processes may contribute to the ongoing conflict in the DRC,"[699] and it is "comfortable that legitimate recycled post-consumer or scrap minerals do not contribute to the crisis and can be therefore identified as 'DRC conflict free.'"[700] We are aware that the underlying conflict minerals that were recycled or from scrap sources may have once directly or indirectly financed or benefited armed groups in the Covered Countries. However, because the purpose of the provision is to provide information about whether minerals used in manufacturing directly or indirectly financed or benefited armed groups in the Covered Countries, and conflict minerals from recycled or scrap sources no longer do so, we believe it is appropriate to deem all products with conflict minerals from recycled or scrap source as "DRC conflict free."[701] This prevents the final rule from providing a disincentive to use conflict minerals from recycled or scrap sources.

**i. Definition of "Recycled and Scrap Sources"**

We are revising the proposed rules to adopt a definition of conflict minerals from recycled or scrap sources, which mirrors the OECD definition of recycled metals.[702] We are persuaded by commentators that argued that it is important for us to prescribe clear definitions regarding conflict minerals from recycled or scrap sources so that an issuer

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[699] See letter from TIAA-CREF.

[700] See id.

[701] We also note that, going forward, newly mined minerals, even if they are eventually recycled, will be covered under the final rule when they are first used.

[702] See OECD, DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS, 12 n.2 (2011), available at, http://www.oecd.org/dataoecd/62/30/46740847.pdf. ("Recycled metals are reclaimed end-user or post-consumer products, or scrap processed metals created during product manufacturing. Recycled metal includes excess, obsolete, defective, and scrap metal materials which contain refined or processed metals that are appropriate to recycle in the production of tin, tantalum, tungsten and/or gold. Minerals partially processed, unprocessed or a bi-product from another ore are not recycled metals.").

does not use this alternative reporting scheme as a means to avoid the requirement to exercise due diligence on the source and chain of custody of its conflict minerals in order to describe its products as "DRC conflict free."[703] Also, we agree with one of these commentators that the definition should be included in the body of the final rule and not just included as guidance in the release.[704]

Further, we are persuaded by commentators that we should use the OECD definition to provide certainty and prevent an issuer from using an alternative definition that would allow the issuer to classify it minerals as recycled or scrap when they were not.[705] Therefore, the final rule states that conflict minerals are considered to be from recycled or scrap sources if they are from recycled metals, which are reclaimed end-user or post-consumer products, or scrap processed metals created during product manufacturing. Also, based on the OECD definition, the final rule states that recycled metal includes excess, obsolete, defective, and scrap metal materials that contain refined or processed metals that are appropriate to recycle in the production of tin, tantalum, tungsten and/or gold. The final rule states further, however, that minerals partially processed, unprocessed, or a byproduct from another ore will not be included in the definition of recycled metal.

The definition included in the final rule should alleviate certain commentators' concern that the Proposing Release would limit the definition of conflict minerals from recycled or scrap sources to only end-user or post-consumer scrap and not include scrap

[703] See, e.g., letters from Global Witness I, MSG I, and SIF I.

[704] See letter from Global Witness I.

[705] See, e.g., letters from Global Witness I, MSG I, and SIF I.

processed metals created during product manufacturing.[706] The final rule's definition, which is consistent with the OECD definition, includes scrap processed metals created during product manufacturing.

#### ii. Due Diligence for Conflict Minerals that May Not Be From "Recycled and Scrap Sources"

In a change from the proposal, the final rule only requires an issuer with conflict minerals from recycled or scrap sources to exercise due diligence if it has reason to believe, following its reasonable country of origin inquiry, that its conflict minerals that it thought were from recycled or scrap sources may not be from such sources. If so, as is true for issuers with conflict minerals from newly mined sources, the issuer must exercise due diligence that conforms to a nationally or internationally recognized due diligence framework, if such a framework is available. The proposed rules would have required issuers with conflict minerals from recycled or scrap sources to exercise due diligence in determining that their conflict minerals were from recycled or scrap sources without requiring adherence to any due diligence framework. Presently, it appears that the OECD's supplement for gold is the only nationally or internationally recognized due diligence framework for any conflict mineral from recycled or scrap sources. Therefore, we anticipate that issuers would use the gold supplement to conduct their due diligence for gold that issuer has reason to believe may not come from recycled or scrap sources.

However, neither the OECD nor any other body has a similar due diligence framework for cassiterite, columbite-tantalite, or wolframite. Therefore, until such a framework is developed, the required due diligence for issuers who may have those

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706 See letters from Copper & Brass and SSINA.

recycled or scrap conflict minerals is the same as proposed. Those issuers are required to exercise due diligence in determining that their conflict minerals were from recycled or scrap sources without the benefit of a due diligence framework. If, however, a nationally or internationally recognized due diligence framework becomes available for any of the remaining conflict minerals, issuers will be required to utilize that framework for that mineral. Specifically, if due diligence guidance for a particular conflict mineral under a nationally or internationally recognized due diligence framework becomes available prior to June 30 of a calendar year, the first reporting period in which issuers must use the framework for that conflict mineral will be the subsequent calendar year. However, if the due diligence guidance is not approved until after June 30 of a calendar year, issuers are not required to use that framework for that conflict mineral until the second calendar year after approval to provide a full year before implementation.

For example, if the OECD or another body adopts a nationally or internationally recognized due diligence framework for cassiterite, columbite-tantalite, or wolframite from recycled or scrap sources prior to June 30, 2013, the initial reporting period in which issuers with those conflict minerals from recycled or scrap sources must use the due diligence framework will begin on January 1, 2014 and their specialized disclosure reports that discuss their exercise of such due diligence will be due on May 31, 2015. If, however, the OECD or another body adopts such a due diligence framework on or after July 1, 2013, but before June 30, 2014, the initial reporting period for issuers with those conflict minerals to use the framework will begin on January 1, 2015 and their specialized disclosure reports with respect to those minerals will be due on May 31, 2016. Issuers with gold from recycled or scrap sources, however, are required to submit a specialized disclosure report for that mineral using the OECD's due diligence for recycled or scrap gold for the reporting period beginning January 1, 2013, which will be due on May 31, 2014.

Further, consistent with the proposal, because our final rule considers products with conflict minerals from recycled or scrap sources to be "DRC conflict free," the final rule does not require a discussion of processing facilities, countries of origin, or efforts to determine the mine or location of origin with the greatest possible specificity. Therefore, we believe that our approach is consistent with comments that indicated that the final rule should not require an issuer with conflict minerals from recycled or scrap sources to provide a Conflict Minerals Report, but should require such issuers to "disclose how they have determined that sources are genuine scrap recycled."[707] Without this disclosure, such issuers "might otherwise be encouraged to 'launder' new DRC conflict minerals through their operations – misleading consumers and other stakeholders, and undermining the value of the disclosure exercise."[708]

### F. Other Matters

If any provision of this rule, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application. Moreover, if any portion of Form SD not related to conflict minerals disclosure is held to be invalid, such invalidity shall not affect

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[707] See letter from NEI.

[708] See id. (recommending also that "[i]ssuers should use due diligence in determining whether conflict minerals are from scrap/recycled sources").

the use of the form for purposes of disclosure pursuant to Exchange Act Section 13(p).

## III. ECONOMIC ANALYSIS

### A. Introduction

As discussed in greater detail above,[709] Section 1502 amended the Exchange Act by adding new Section 13(p), which requires us to promulgate disclosure and reporting regulations regarding the use of conflict minerals from the Covered Countries. Section 13(p) mandates that the Commission promulgate regulations requiring that a person described disclose annually whether any conflict minerals that are necessary to the functionality or production of a product manufactured by such person originated in the Covered Countries, and make that disclosure publicly available on the issuer's Internet website. If a person concludes that the person's conflict minerals originated in the Covered Countries, that person must submit a Conflict Minerals Report, which must be posted on the person's Internet website, that includes a description of the measures taken by the person to exercise due diligence on the minerals' source and chain of custody, which must include an independent private sector audit of the Conflict Minerals Report that is conducted according to standards established by the GAO. The person submitting the Conflict Minerals Report must also identify the independent private sector auditor and certify the independent private sector audit. Further, the report must include a description of the products manufactured or contracted to be manufactured that are not DRC conflict free, the facilities used to process the conflict minerals, the country of origin of the

[709] We are incorporating Sections I and II of this release, which fully describe the statutory requirements of Section 1502 of the Act and the final rule in detail, into Section III of the release and providing only a short summary of the statutory requirements and final rule in this section.

conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity.

We are adopting amendments to our rules to implement the Conflict Minerals Statutory Provision. The final rule requires any reporting issuer for which conflict minerals are necessary to the functionality or production of a product manufactured or contracted to be manufactured by that issuer to disclose annually in a separate specialized disclosure report on a new form the results of its reasonable inquiry into whether its conflict minerals originated in the Covered Countries or came from recycled or scrap sources. Under the final rule, following its reasonable country of origin inquiry, if (a) the issuer knows that its conflict minerals did not originate in the Covered Countries or knows that they came from recycled or scrap sources, or (b) the issuer has no reason to believe its conflict minerals may have originated in the Covered Countries, or (c) the issuer reasonably believes its conflict minerals came from recycled or scrap sources, then in all such cases the issuer must, in the body of Form SD, disclose its determination and describe briefly the reasonable country of origin inquiry it undertook and the results of the inquiry. On the other hand, following its reasonable country of origin inquiry, if (a) the issuer knows that its conflict minerals originated in the Covered Countries and knows that they did not come from recycled or scrap sources, or the issuer has reason to believe that its conflict minerals may have originated in the Covered Countries, <u>and</u> (b) the issuer knows that its conflict minerals did not come from recycled or scrap sources or has reason to believe that its conflict minerals may not have come from recycled or scrap sources, then the issuer must exercise due diligence on the source and chain of custody of its conflict minerals that conforms to a nationally or internationally recognized due diligence framework, if one is available. Following that due diligence, unless the issuer determines, based on that due diligence, that its conflict minerals did not originate in the Covered Countries or that its conflict minerals did come from recycled or scrap sources, the issuer must file a Conflict Minerals Report.

In most circumstances, the issuer must obtain an independent private sector audit of its Conflict Minerals Report. The issuer must also describe in its Conflict Minerals Report, among other information, its products manufactured or contracted to be manufactured that have not been found to be "DRC conflict free." For a temporary two-year period for all issuers, and for a temporary four-year period for smaller reporting issuers, an issuer that must perform due diligence and is unable to determine that the conflict minerals in its products originated in the Covered Countries or came from recycled or scrap sources, or unable to determine that the conflict minerals in those products that originated in the Covered Countries financed or benefited armed groups, may consider those products "DRC conflict undeterminable." In that case, the issuer must describe, among other information, its products manufactured or contracted to be manufactured that are "DRC conflict undeterminable" and the steps it has taken or will take, if any, since the end of the period covered in its most recent prior Conflict Minerals Report to mitigate the risk that its necessary conflict minerals benefit armed groups, including any steps to improve its due diligence. An issuer with products that are "DRC conflict undeterminable" is not required to obtain an independent private sector audit of the Conflict Minerals Report regarding the conflict minerals in those products.

Finally, after its reasonable country of origin inquiry, an issuer that determines that its conflict minerals it thought were from recycled or scrap sources might instead be from newly mined sources must exercise due diligence that conforms to a nationally or internationally recognized due diligence framework developed specifically for conflict minerals from recycled sources to determine that its conflict minerals are from recycled or scrap sources. The issuer must also describe its due diligence in its Conflict Minerals Report. Currently, gold is the only conflict mineral with a nationally or internationally recognized due diligence framework for recycled or scrap conflict minerals. If no nationally or internationally recognized due diligence framework for a particular recycled or scrap conflict mineral is available, which is the case for the other three minerals, until such a framework is developed, the issuer must exercise due diligence in determining that its conflict minerals are from recycled or scrap sources and describe the due diligence measures it exercised in its Conflict Minerals Report.

As we considered how to implement the requirements of Section 1502, we considered the costs and benefits imposed by the new rule and form we are adopting, as well as their effects on efficiency, competition, and capital formation. Many of the economic effects of the rule stem from the statutory mandate, and the discussion below addresses the costs and benefits resulting from both the statute and from our exercise of discretion, and the comments we received about these matters.

The Proposing Release cited some pre-proposal letters we received from commentators indicating the potential impact of the proposed rules on competition and capital formation. In addition to requesting comment throughout the release on the proposal and on potential alternatives to the proposal, we also solicited comment in the Proposing Release on whether the proposal, if adopted, would promote efficiency, competition, or capital formation, or have an impact or burden on competition. We also requested comment on the potential effect on efficiency, competition, or capital formation should we not adopt certain exceptions or accommodations. As discussed throughout this release, we received many comments addressing the potential economic and competitive impact of the proposed rules.

We note, however, that one commentator recommended that the proposed rules be withdrawn because the commentator did not believe we fully analyzed the potential costs, supply chain complexities, and other practical obstacles to implementing the final rule.[710] We disagree. As discussed above, members of the public interested in making their views known were invited to submit comment letters in advance of the official comment period for the proposed rules. In addition, in response to the suggestion by some commentators that we extend the comment period to allow the public additional time to thoroughly consider the matters addressed in the Proposing Release and to submit comprehensive responses, we extended the comment period for an additional 30 days and have continued to receive comment letters through August 2012, which we have considered. In addition, we convened an October 2011 roundtable at the request of commentators. Some commentators have provided responses to other commentators, particularly on the Economic Analysis. This robust, public, and interactive debate has allowed us to more fully consider how to develop our final rules. Additionally, as discussed further in the Economic Analysis section, below, we have considered and analyzed the numerous comments received regarding the costs and complexities of the statute and proposed rule, and have taken them into account in the final rule. Overall, we

[710] See letter from Chamber I.

believe interested parties have had sufficient opportunity to review the proposed rules, as well as the comment letters, and to provide views on the proposals and on the other comment letters and data to inform our consideration of the final rules. Accordingly, we do not believe that withdrawal of the proposed rule and re-proposal is necessary.

After analyzing the comments and taking into account additional data and information, we believe it is likely that the initial cost of compliance is approximately \$3 billion to \$4 billion, while the annual cost of ongoing compliance will be between \$207 million and \$609 million. As discussed in detail below, we reach this estimate by taking into account the many comments we received on potential costs, relying particularly on those comment letters that provided quantification and were transparent about their methodologies. As will be discussed in more detail below, after thoroughly considering each comment letter, we determined that it was appropriate to modify and/or expand upon some of the submitted estimates and methodologies to reflect data and information submitted by other commentators, as well as our own judgment and experience. Our considered estimate of the total costs thus reflects these synthesized data and analyses. We consider the full range of these costs in the following sections, although where it is possible to discuss separately the costs and benefits related to our discretionary choices in the rule, we attempt to do so.[711]

Exchange Act Section 23(a)(2)[712] also requires us, when adopting rules under the

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[711] As discussed above, our discretionary choices are informed by the statutory mandate and thus, discussion of the benefits and costs of those choices will necessarily involve the benefits and costs of the underlying statute.

[712] 15 U.S.C. 78w(a)(2).

Exchange Act, to consider the impact that any new rule would have on competition, and Exchange Act Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, Exchange Act Section 3(f)[713] requires us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider whether the action will promote efficiency, competition, and capital formation. Accordingly, as we considered how to implement the requirements of Section 1502, we considered the impact on the economy, burden on competition, and promotion of efficiency, competition, and capital formation.

Given the specific language of the statute and our understanding of Congress's objectives, we believe it is appropriate for the final rule generally to track the statutory provision. Our discretionary authority to implement Section 13(p) is limited, and we are committed to executing the Congressional mandate. Throughout this release, and in the following Economic Analysis, we discuss the benefits and costs arising from the new mandatory reporting requirement, those choices in which we have exercised our discretion, and the comments we received about these matters. Sections III.B and III.C below provide a narrative discussion of the costs and benefits resulting from the mandatory reporting requirement and our exercise of discretion, respectively. In Section III.D below, based on commentators' estimates and our estimates, we provide a

[713] 15 U.S.C. 78c(f).

quantitative discussion of the costs associated with the final rule as adopted.[714]

### B. Benefits and Costs Resulting from the Mandatory Reporting Requirement

#### 1. Benefits

Congress intended for the rule issued pursuant to Section 1502 to decrease the conflict and violence in the DRC, particularly sexual and gender based violence.[715] We note also that the Congressional object is to promote peace and security in the Covered Countries.[716] As a means to address the humanitarian situation in the DRC, new Section 13(p) requires issuers to understand and report on their use and source of certain minerals from the Covered Countries. By mandating the additional disclosure requirements of Exchange Act Section 13(p), we understand that Congress likely sought to reduce the amount of money provided to armed groups engaged in conflict in the DRC,[717] thereby

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714 As noted below, Congress's goals of reducing violence and promoting peace and security in the Covered Countries, as well as enhanced transparency through Section 13(p) and this rulemaking is intended to result in benefits that cannot be readily quantified with any precision, and therefore, our quantitative analysis focuses on the costs.

715 Section 1502(a) of the Act ("It is the sense of the Congress that the exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation therein, warranting the provisions of section 13(p) of the Securities Exchange Act of 1934, as added by subsection (b).").

716 See Exchange Act Section 1502(c)(1)(B)(i) (stating that the Secretary of State, in consultation with the Administrator of the United States Agency for International Development, shall submit to Congress a plan to "promote peace and security" in the Covered Countries). See also Section 1502(d)(2)(A) of the Act (directing the GAO to assess the effectiveness of Exchange Act Section 13(p) in promoting peace and security in the Covered Countries).

717 Cf. Exchange Act Section 1502(c)(1) requiring the Secretary of State in consultation with the Administrator of the United States Agency for International Development to submit a report to Congress discussing a strategy to address the linkages between human rights abuses, armed groups, mining of conflict minerals, and commercial products that includes a plan to promote peace, a plan to provide guidance to commercial entities seeking to exercise due diligence, and a description of possible punitive measures.

achieving the stated objective of the statute.[718] Some commentators have argued that the Conflict Minerals Statutory Provision has already made progress in this area.[719] For example, some commentators have argued that the Conflict Minerals Statutory Provision has already pressured DRC authorities to begin to demilitarize some mining areas and to increase mining oversight.[720] Congress provided that the disclosure requirements of Exchange Act Section 13(p) shall remain in effect until the President determines and certifies that "no armed groups continue to be directly involved in and benefitting from commercial activity involving conflict minerals."[721]

The statute therefore aims to achieve compelling social benefits, which we are unable to readily quantify with any precision, both because we do not have the data to

[718] As discussed above, some commentators, including co-sponsors of the legislation and other members of Congress, indicated that the Conflict Minerals Statutory Provision also materially informs an investor's understanding of the risks in an issuer's reputation and supply chain. See, e.g., letters from CRS I, FRS, Global Witness I, Methodist Pension, Sen. Durbin / Rep. McDermott, Sen. Leahy et al., SIF I, and SIF II.

[719] See, e.g., letters from International Corporate Accountability Roundtable (Jul. 29, 2011) ("ICAR I"), Sen. Boxer et al. I, Sen. Leahy et al., and United Nations Group of Experts on the Democratic Republic of Congo (Oct. 21, 2011) ("UN Group of Experts"). Other commentators, however, have argued that the Conflict Minerals Statutory Provision has hurt the general economy and population of the DRC. See, e.g., letters from BEST II ("Though [the Conflict Minerals Statutory Provision] seeks to provide a mechanism for combating the corruption and violence crippling the DRC, its impact on the upstream mining industry has been devastating to the mining communities and the broader economy of Eastern DRC."), CEI II ("There are already indications that Dodd-Frank has had damaging consequences for the artisanal miners. In a recently published New York Times op-ed, freelance reporter David Aronson observed that the law is harming the very people it is aimed at protecting, and that the sole beneficiaries are those perpetrating the violence."), and FEC II (stating that, "we can confirm today that as expected there is more smuggling activities, very big decrease in revenue of the Government of DRC, huge impact on the live hoods of thousands of Congolese, there is no more formal business in the Kivus due to this interpretation of consumers which is far more than the requirements of the law and does not give chance for the improvements that had already begun to work").

[720] See, e.g., Sen. Boxer et al. II, Sen. Leahy et al., and United Nations Group of Experts on the Democratic Republic of Congo (Oct. 21, 2011) ("UN Group of Experts"). Other commentators, however, have argued that the Conflict Minerals Statutory Provision has hurt the general economy and population of the DRC. See, e.g., letters from BEST II, CEI II, and FEC II.

[721] Exchange Act Section 13(p)(4).

quantify the benefits and because we are not able to assess how effective Section 1502 will be in achieving those benefits. Additionally, the social benefits are quite different from the economic or investor protection benefits that our rules ordinarily strive to achieve.

We also note that these objectives of Section 1502 do not appear to be those that will necessarily generate measurable, direct economic benefits to investors or issuers. Some commentators urged, however, that conflict minerals information is material to an investment decision and, therefore, similar to other disclosures required to be filed by issuers.[722] For example, one commentator noted that, "[a]s a sustainable and responsible investor," this commentator "values companies' prudent management of risk in their global supply chains and has been particularly concerned in recent years by the use of certain minerals to fund the continuing bloody conflict in the" DRC.[723] As another example, a different commentator stated that, "[a]s sustainable and responsible investors, we carefully assess the prudent management of risk in companies' global supply chains and we have been particularly concerned in recent years by the use of certain minerals, namely tin, tantalum, tungsten and gold, to fund the continuing bloody conflict in the" DRC.[724]

### 2. Cost Estimates in the Comment Letters

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[722] See letters from Calvert, Global Witness I, Sen. Durbin / Rep. McDermott Sen. Leahy et al., SIF I, SIF II, and TIAA-CREFF. But see letters from AngloGold, Barrick Gold, Cleary Gottlieb, Corporate Secretaries I, Deloitte, Ford, ITIC I, JVC et al. II, NAM III, NMA II, NY State Bar, Taiwan Semi, and WGC II (arguing that the conflict minerals information is not material to an

[723] See letter from Calvert.

[724] See letter from SIF II.

In the Proposing Release, we included our estimates of the costs of the disclosure requirements.[725] A number of commentators indicated that we underestimated the costs.[726] One commentator, however, asserted that Economic Analysis was both "thorough and accurate."[727] In this regard, another commentator stated that the cost estimates in comment letters from industry "seem[ed] significantly inflated."[728] Some commentators discussed the costs in a more specific manner. In the Specific Comments section below, we discuss the comments we consider to be the most useful regarding the costs of the disclosure requirements. In both the general and specific comments, commentators did not typically distinguish between the costs and benefits of the statutory mandate and the costs and benefits of the specific aspects of the rule for which we exercised discretion. The overall specific cost range provided by commentators, as discussed in greater detail below, was between $387,650,000[729] and $16 billion.[730] In analyzing the comments, we believe it is more likely that the initial cost of complying

[725] In the Proposing Release, we estimated solely for the purposes of the Paperwork Reduction Act the total annual increase in the paperwork burden for all affected companies to comply with our proposed collection of information requirements to be approximately 153,864 hours of company personnel time and to be approximately $71,243,000 for the services of outside professionals. Also, we estimated that the PRA burden for the audit and due diligence requirements to the industry would be approximately $46,475,000. These cost estimates were calculated based on the effect that the proposed rules and form amendments, if adopted, would have on those collections of information as a result of the required due diligence process and independent private sector audit of the Conflict Minerals Report.

[726] See, e.g., letters from Barrick Gold, CEI II, Chamber I, Ford, Howland, IPC I, ITRI I, ITRI II, NAM I, NRF I, PCP, Rep. Lee, RILA, TriQuint I, Tulane University Payson Center for International Development (Oct. 25, 2011) ("Tulane"), and WGC II.

[727] See letter from ICAR et al. I.

[728] See letter from Enough Project IV.

[729] See letter from Claigan III.

[730] See letter from NAM I.

with the statutory requirement is approximately $3 billion to $4 billion. We explain why as we consider and describe the full range of these costs below, although where it is possible to discuss separately the costs and benefits related to our discretionary choices in the rule, we attempt to do so.

### a. General Comments

Most commentators stated that they fully support the humanitarian goals of the Conflict Minerals Statutory Provision of reducing the levels of violence in the DRC,[731] but some commentators argued that the Proposing Release did not adequately demonstrate any benefits to investors.[732] As noted above, the purpose of Section 1502 is furthering the humanitarian goals of reducing violence and advancing peace and security in the DRC and the benefits Congress intended are derived directly from the statute. Other commentators, including two of the co-sponsors of the provision and other members of Congress, have indicated in comment letters that the provision also serves important investor protection objectives, such as additional disclosure on a company's supply chain,[733] although the legislative history and statutory language do not generally reference investor protection. Therefore, we have designed a final rule to help achieve the intended humanitarian benefits in the way that Congress directed, even though we recognize that the final rule will impose significant compliance costs on companies who

[731] See, e.g., letters from ABA, Chamber I, Industry Group Coalition I, NAM I, and WGC II.

[732] See, e.g., letters from Chamber I and PCP. These commentators stated also that the Proposing Release did not demonstrate adequately the proposed rules' efficiencies for the market place or any promotion of capital formation, as discussed below.

[733] See, e.g., letter from Senator Leahy et al. ("[I]t seems abundantly clear that when a publicly traded company relies on an unstable black market for inputs essential to manufacturing its products it is of deep material interest to investors.").

use or supply conflict minerals. Although, as one commentator noted, it would be difficult to determine a realistic cost approximation,[734] most of these commentators believed that compliance costs would be high.

**b. Specific Comments**

Four commentators in particular attempted to catalogue the expense of complying with the new reporting requirements. The commentators generally focused on three categories of costs as the most significant: due diligence for both suppliers and issuers; information technology ("IT") costs, and audit costs. Although there is a general consensus among these four commentators as to the broadest categories of significant costs, in several cases they provided divergent cost estimates as well as supplying differing levels of detail as to how they developed these estimates. The following section is intended to lay out the cost estimates as submitted by the commentators.

**i. Manufacturing Industry Association Comments**

In its comment letter, a manufacturing industry association[735] stated that, based on its research, of the 5,994 issuers that the Proposing Release stated could be affected by the final rule, the average issuer would have between 2,000 and 10,000 first-tier suppliers, which would result in the total initial costs to issuers of complying with the final rule being anywhere from approximately $8 billion to $16 billion.[736]

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[734] See letter from Howland.

[735] See letter from NAM I. The manufacturing industry association indicated that, in developing its cost estimates, it consulted with its manufacturing members and relied on research by The Global Research Center for Strategic Supply Management at the W.P. Carey School of Business at Arizona State University.

[736] But see letter from the Fafo Institute for Applied International Studies (Oct. 17, 2011) ("Fafo"). This commentator asserted that the manufacturing industry association's cost estimate was too high because of some incorrect assumptions regarding an issuer's costs of changing legal obligations, obtaining an

The industry association noted that "a large portion of America's 278 thousand small and medium-sized manufacturers could be affected by the requirement to provide information on the origin of the minerals in the parts and components they supply to companies subject to the SEC." It estimated, however, that "only one in five smaller companies would be in one or more issuer's supply chains,"[737] and these smaller companies' only costs regarding the proposed rules would be a $25,000 audit cost. Therefore, the proposed rules would cost smaller companies, which are not required to report with us under Exchange Act Sections 13(a) or 15(d), approximately $1.4 billion.[738]

Further, the commentator remarked that our $25,000 estimate[739] of the cost of the independent private sector audit "would only cover the initiation of an audit for a small company with a simple supply chain," and argued that, at a minimum, an independent private sector audit of a company with a more complex supply chain would cost at least $100,000.[740] Additionally, the manufacturing industry association "conservatively estimate[d]" that approximately 75% of the issuers that would be required to provide conflict minerals information also would be required to provide a Conflict Minerals Report and an audit rather than the 20% that we estimated in the Proposing Release,

independent private sector audit, monitoring of the supply chain, administering procurement and contracts, implementing remediation recommendations, conducting internal audits of its due diligence system, and reporting to the Commission.

[737] 278,000 x .20 = 55,600.

[738] 278,000 x .20 x $25,000 = $1,390,000,000.

[739] As discussed in the Proposing Release, we indicated that each independent private sector audit of the Conflict Minerals Report would cost approximately $25,000 on average based on the preliminarily estimates of one industry group.

[740] See letter from NAM I.

which would equate to approximately 4,500 issuers out of the 5,994 issuers we estimated would be affect by the final rule.[741] Taking into consideration the higher estimated number of affected issuers, the industry association estimated that the total cost to all affected issuers to obtain an independent private sector audit of their Conflict Minerals Report would be $450 million.

In addition, the commentator estimated that, to implement their new due diligence policies, it would cost $1.2 billion for the 5,994 affected issuers to change their legal obligations with each issuer's estimated 2,000 first-tier suppliers, and an additional $300 million for issuers to implement risk-based programs that use control processes to verify that suppliers are providing them with credible information and pushing legal obligations upstream. Also, the commentator estimated that affected issuers would need to expend a collective total of $6 billion to develop new information technology systems to collect information on each issuer's first-tier suppliers.[742] Therefore, the sum of the costs to affected issuers would total approximately $8 billion. Below is a summary of the manufacturing industry association's cost estimates in tabular form:

| **Manufacturing Industry Association Commentator Estimate** | | Calculation |
|---|---|---|
| Issuers affected | 5,994 | |
| Average Number of 1st tier suppliers | 2,000 | |
| | | |

[741] See id. The manufacturing industry association commentator estimated that 75% of affected issuers would be required to submit a Conflict Minerals Report because, according to the commentator, the majority of issuers would not be able to determine the origin of their conflict minerals.

[742] See letter from NAM I.

| | | |
|---|---|---|
| **Issuer Due Diligence Reform**[743] | | |
| Number of compliance hours per issuer | 2 | |
| Cost per hour | $50 | |
| **Total compliance cost** | ***$1,198,800,000*** | 5,994*2000*2*$50 |
| | | |
| **IT Systems Modification**[744] | | |
| Cost per issuer | $1,000,000 | |
| **Total cost** | ***$5,994,000,000*** | 5,994*$1,000,000 |
| | | |
| **Conflict Minerals Report Audits** | | |
| Issuers affected[745] | 4,500 | 5,994*75% |
| Audit cost | $100,000 | |
| **Total cost** | ***$450,000,000*** | 4,500*100,000 |
| | | |
| **Issuer Verification of Supplier Information** | | |
| Number of hours | 0.5 | |
| Cost per hour | $50 | |
| **Total cost** | ***$299,700,000*** | 5,994*2000*0.5*$50 |
| | | |
| **Smaller Supplier Due Diligence**[746] | | |
| Suppliers affected (only 20% to conduct)[747] | 55,600 | 278,000 * .2 |
| Due diligence cost | $25,000 | |
| **Total cost** | ***$1,390,000,000*** | 278,000*.2*$25,000 |
| | | |
| **TOTAL** | **$9,332,500,000** | |
| | | |
| TOTAL for affected issuers | $7,942,500,000 | $9,332,500,000- *$1,390,000,000* |

[743] The manufacturing industry association commentator refers to this as "changes to corporate compliance policies."

[744] The manufacturing industry association commentator refers to this as IT system development or revision.

[745] We are using the rounded estimate (4,500) that was used by the university group and manufacturing industry association commentators in their calculations even though a more exact number of issuers would be 4,496 (.75 x 5,994 = 4,495.5). See infra note 869.

[746] The manufacturing industry association commentator refers to this as the cost of "provid[ing] proper information regarding the source of minerals."

[747] Supplier compliance cost in the manufacturing industry association commentator's proposal is considered an audit cost and is not limited to smaller suppliers that are issuers.

Additionally, this commentator calculated that the costs of the final rule could be "as high as $16 billion" by "extrapolating from the recent experience of company costs in complying with the European Union's hazardous waste directive ("RoHS"), and estimated on that basis the economic impact of the SEC's proposed regulations."[748] In fact, this commentator postulated that "Section 1502 may be broader in scope because" it "covers more products and sectors than RoHS," it "discriminates against origin," and it "does not include a de minimis or weight-based exception."[749] The commentator stated that, according to Technology Forecasters, Inc., the RoHS directive cost the electronics industry $2,640,000 per company to achieve initial RoHS compliance and another $482,000 annually to maintain compliance. Therefore, based on these per company figures, the commentator calculated that initial compliance of all 5,994 issuers would be approximately $16 billion.

#### ii. Electronic Interconnect Industry Association Comments

Another commentator, an electronic interconnect industry association,[750] estimated that the electronic interconnection industry suppliers would incur compliance costs of approximately $279 million in the first year and approximately $165 million in

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748 See letter from NAM I. This commentator estimated that each issuer affected by RoHS had an initial compliance cost of $2,640,000. For the 5,994 issuers that we estimate may be affected by the final rule, the estimated total cost to comply with RoHS would be $15,824,160,000 ($2,640,000 x 5,994 = $15,824,160,000).

749 See id.

750 See letter from IPC I.

ongoing annual costs.[751] Additionally, this commentator stated that there could be additional hidden costs for companies that varied widely from no additional costs to more than $2 million in such costs.[752] This commentator did not provide an estimate of the costs to all potentially affected issuers, but focused on the electronic interconnect industry.

The electronic interconnect industry association also argued that more than 20% of the 5,994 affected issuers would have to provide an independent private sector audit.[753] The commentator noted that, although the Covered Countries may, at most, supply 20% of the world's supply of conflict minerals, this 20% could be distributed to 100% of the issuers. Therefore, all issuers could be required to file a Conflict Minerals Report and obtain an independent private sector audit, and the electronic interconnect industry group "expected that nearly 100% of affected issuers will need to complete a [Conflict Minerals Report], especially in the initial years of the regulation."[754] In this regard, the commentator noted that respondents to its survey stated that "[s]upplier verification and auditing was a frequently cited anticipated cost," and the respondents "estimated direct

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751 See id. The letter includes an Appendix A, which consists of a published survey produced by Market Research Service of the electronic interconnect industry association commentator entitled, "Results of an IPC Survey on the Impact of U.S. Conflict Minerals Reporting Requirements" (Feb. 2011) ("electronic interconnect industry group survey"). Much of the information cited from this commentator is located in the published survey. For the survey, the commentator surveyed 3,839 of its members in the electronic interconnection industry with a total of 60 separate companies actually participating in the survey. Of these 60 companies, 30% were public issuers while the remaining 70% were private companies. Despite acknowledging that the survey was not intended "to produce statistical significant data," the commentator argued that the survey respondents do "make up a representative sample of the U.S. electronic interconnect supply chain." See id.

752 See id.

753 Id.

754 See id. This commentator noted as well that "the vast majority of users will be unable to identify the origin of their conflict minerals…and therefore will need to complete" a Conflict Minerals Report.

costs of [$]10,000 to [$]100,000 for the third party due diligence audits."[755] The commentator also indicated that the average number of suppliers in the supply chain for those companies responding to their survey was 163.

### iii. University Group Comments

Another commentator, a university group, provided its own cost figures regarding the proposed rules in its comment letter.[756] The university group contended that our model underestimated the costs of the proposed rules due to, among other reasons, our failure to consider the costs incurred by all actors, especially first-tier private company suppliers, that are required to modify their management systems to provide critical information to its customers that are the issuers. In contrast, the university group found that the manufacturing industry group's economic model overstated the costs by overestimating the number of suppliers and failing to account for cost efficiencies.

The university group contended that all affected companies, both issuers and private companies, would need to carry out three principal actions to implement Section 1502. These actions consisted of strengthening internal management systems in view of performing due diligence, instituting necessary information technology systems, and obtaining independent private sector audits. The university group's model indicated that the largest driving cost factor was strengthening companies' management systems, which would total approximately $5.17 billion for both issuers and private companies, with

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[755] See id.

[756] See letter from Tulane. The staff of Senator Richard J. Durbin, one of the co-sponsors of the Conflict Minerals Statutory Provision, contacted this commentator "with a specific request for help in providing a detailed estimate of what it would cost companies to implement the Congo Conflict Mineral Act." Id.

issuers' costs being approximately $26 million and private companies' costs being approximately $5.14 billion. The other costs would be borne only by issuers. These other costs included instituting the necessary information technology systems, which would cost approximately $2.56 billion, and obtaining an independent private sector audit, which would cost companies approximately $207 million. Ultimately, according to the university group, the proposed rules would cost all affected companies, both issuers and private companies involved in the conflict minerals supply chain, approximately $7.93 billion initially and approximately $207 million annually thereafter.

As noted, the university group commentator estimated the due diligence costs to both issuers and their private company suppliers. The total initial labor costs, including both laborers and consultants, to all 5,994 issuers would be approximately $26 million. For the costs to private company suppliers, the university group estimated the total number of small private company suppliers to be 148,459, and the number of large private company suppliers to be 711,607.[757] The total initial labor costs, including both laborers and consultants, to all 860,066 private company suppliers would be approximately $5.14 billion. In sum, the total initial labor costs for due diligence to both the 5,994 issuers and the 860,066 private company suppliers would be approximately $5.17 billion.

Also, the university group disagreed with the manufacturing industry group's

[757] The university group commentator developed these estimates by multiplying the number of issuers by the company size factor (large or small) and multiplying the number of relevant first tier supplier contracts by an overlap factor of 0.40. This factor attempts to differentiate and correct for the number of estimated material supply contracts versus the number of unique businesses impacted. Tulane estimated a 60% overlap factor meaning that only 40% (100% - 60% = 40%) of the supply contracts corresponded to non-overlapping suppliers. See letter from Tulane.

estimate that the costs for modifying each issuer's information technology systems would be $1 million. The university group agreed that these costs would be borne solely by issuers because they would be responsible for creating tracking systems for the supplier-furnished supply chain information, and that large issuers that use complex information technology systems to manage their supply chains would have costs of $1 million per company. However, the university group argued that the unit costs for small companies, based on the data from the 2011 electronic interconnect industry association commentator survey, would be $205,000 per company. The university group estimated that the information technology costs for the affected small issuers would be approximately $885 million, and the cost for the affected large issuers would be approximately $1.68 billion. Therefore, the total costs to the 5,994 affected issuers of changing information technology systems would be approximately $2.56 billion.

Finally, the university group discussed the costs associated with the independent private sector audit. The university group disagreed with the manufacturing industry group's assertion that private company suppliers would be required to obtain a private sector audit to demonstrate to their issuer customers that they performed sufficient due diligence. The university group noted that there is no requirement that private company suppliers obtain such an audit, so the burden and cost for a private company supplier to obtain an audit is voluntary in the context of the proposed rules. Further, the university group noted that the impetus for issuers to demand such audits would be reduced if issuers are allowed to use "reasonably reliable representations" from suppliers. For these reasons, the university group excluded any costs for independent private sector audits for private company suppliers from their cost estimates. The university group, however, agreed with the manufacturing industry group's cost estimates and indicated that the cost for an audit of a small issuer would be $25,000 and the cost to a large issuer would be $100,000. Based on these assumptions, the university group estimated that the audit costs for small issuers would be $81 million,[758] and those costs for large issuers would be approximately $126 million.[759] Therefore, the total audit cost for all issuers would be approximately $207 million per year.[760] Below is a summary of the university group commentator's estimates in tabular form:

| University Group Commentator Estimate | | Calculation |
|---|---|---|
| Issuers affected | 5,994 | |
| Large issuer (28% of issuers) | 1,678 | 5,994*0.28 |
| Small issuer (72% of issuers) | 4,316 | 5,994*0.72 |
| Average number of 1st tier suppliers (53% of manufacturing industry association commentator) | 1,060 | 2,000*0.53 |
| | | |
| **Issuer Due Diligence Reform** | | |
| Number of compliance hours for large issuer | 100 | |
| Number of compliance hours for small issuer | 40 | |
| Internal cost per hour | $50 | |
| Internal costs for large issuer (90% of total work load) | *$7,551,000* | 1,678*0.9*100*$50 |
| Internal costs for small issuer (75% of total work load) | *$6,473,520* | 4,316*0.75*40*$50 |
| Consulting cost per hour | $200 | |
| Consulting costs for large issuer (10% of total work load) | *$3,356,000* | 1,678*0.1*100*$200 |
| Consulting costs for small issuer (25% of total work load) | *$8,632,000* | 4,316*0.25*40*$200 |
| **Total cost** | ***$26,013,000*** | |
| | | |

[758] 5,994 issuers x 75% of issuers requiring an audit x 72% for number of small issuers x $25,000 per audit = $80,919,000.

[759] 5,994 issuers x 75% of issuers requiring an audit x 28% for number of large issuers x $100,000 per audit = $125,874,000.

[760] $80,919,000 + $125,874,000 = $206,793,000.

| | | |
|---|---|---|
| **IT Systems Modification** | | |
| Cost per large issuer | $1,000,000 | |
| Cost per small issuer | $205,000 | |
| Total large issuer cost | *$1,678,000,000* | 1,678*$1,000,000 |
| Total small issuer cost | *$884,780,000* | 4,316*$205,000 |
| **Total costs** | *$2,562,780,000* | |
| | | |
| **Conflict Minerals Report Audits** | | |
| Issuers affected[761] | 4,500 | |
| Number of large issuers | 1,260 | 4,500*0.72 |
| Number of small issuers | 3,240 | 4,500*0.28 |
| Large issuer cost | $100,000 | |
| Small issuer cost | $25,000 | |
| Total costs for large issuers | *$ 126,000,000* | 1,260*$100,000 |
| Total costs for small issuers | *$81,000,000* | 3,240*$25,000 |
| **Total costs** | *$ 207,000,000* | |
| | | |
| **Supplier Due Diligence Reform** | | |
| Average number of 1st tier supply contracts per large issuer | 1,060 | |
| Average number of 1st tier supply contracts per small issuer | 86 | |
| Overlap factor (percent of suppliers affected) | 0.4 | |
| Total large suppliers | 711,472 | 1,678*1,060*0.4 |
| Total small suppliers | 148,470 | 4,316*86*0.4 |
| Number of compliance hours for large supplier | 100 | |
| Number of compliance hours for small supplier | 40 | |
| Internal cost per hour | $50 | |
| Internal costs for large supplier (90% of total work load) | *$3,201,624,000* | 711,472*100*0.9*$50 |
| Internal costs for small supplier (75% of total work load) | *$222,705,000* | 148,470*40*0.75*$50 |
| Consulting cost per hour | $200 | |
| Consulting costs for large supplier (10% of total work load) | *$1,422,944,000* | 711,472*100*0.1*$200 |
| Consulting costs for small supplier (25% of total work load) | *$296,940,000* | 148,470*40*0.25*$200 |
| **Total cost** | *$5,144,213,000* | |
| | | |

[761] We are using the rounded estimate (4,500) that was used by the university group and manufacturing industry association commentators in their calculations even though a more exact number of issuers would be 4,496 (.75 x 5,994 = 4,495.5). See infra note 869.

| TOTAL | $7,940,006,000 | |
|---|---|---|

### iv. Environmental Consultancy Company Comments

An additional commentator, an environmental consultancy company, provided cost figures regarding the proposed rules.[762] The environmental consultancy company asserted that the models provided by the manufacturing industry group and the university group significantly overestimated the costs of the proposed rules, whereas our PRA section underestimated the paperwork costs. Specifically, the commentator stated that the manufacturing industry association group's and the university group's "estimates provide cost projections that do not reflect current industry practice in compliance programs by the vast majority of affected issuers," so it "would be inadvisable to use" their "data as the basis for an accurate cost estimate for implementation of Section 1502."[763]

Also, the environmental consultancy company argued that we underestimated the costs of the proposed rules primarily because we overestimated issuers' knowledge of the origin of materials in their products. According to the commentator, most of the compliance costs for the proposed rules would be derived from identifying where an issuer's materials are sourced. Further, the commentator suggested that our estimate of

[762] See letter from Claigan I. In this letter, the commentator stated that it submitted its letter because it was asked "by Congress and others" to comment on the potential costs of implementing the final rule.

[763] See letter from Claigan Environmental Inc. (Jan. 17, 2012) ("Claigan IV"). But see letters from IPC – Association Connecting Electronics Industries (Feb. 14, 2012) ("IPC III") and National Association of Manufacturers (Feb. 10, 2012) ("NAM IV") (challenging certain of the assumptions made by the environmental consultancy company in its comment letters).

the percentage of affected issuers was too low, we did not recognize that issuers needed to expend greater internal efforts in communicating requirements throughout their companies, we failed to account for the costs of issuers' software changes, and we did not acknowledge that "many companies" may work to a higher standard than the rules would require due to public sensitivity of this issue.

Conversely, the commentator asserted that the manufacturing industry group's $8 billion and the university group's $7.93 billion cost estimates were too high. The environmental consultancy company argued that the manufacturing industry group's estimate regarding the cost for issuers to modify legal responsibilities should be only $300 million, instead of the manufacturing industry group's estimated $1.2 billion.[764] Similarly, the environmental consultancy company maintained that the university group's $5.17 billion estimate to strengthen internal management systems was too high because of incorrect assumptions, and that the actual cost should be only $600 million.[765]

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[764] According to the environmental consultancy company, the manufacturing industry group's assumption that every issuer would have to amend every legal obligation with its suppliers was incorrect because "[a]ll standard contracts with suppliers of public companies contain standard provisions requiring suppliers to comply with relevant laws." Letter from Claigan I. As a result, it would be unlikely that many contracts would need to be modified to enable compliance. Also, the environmental consultancy company asserted that the manufacturing industry group overestimated the cost of modifying legal responsibilities because the manufacturing industry group assumed that every supplier supplies components or products containing conflict minerals to an issuer, which the environmental consultancy company claimed was "very unlikely." Instead, a more reasonable estimate of the numbers of suppliers affected that would require a modification to its legal obligations "would be closer to 50% of suppliers." This commentator asserted that number, however, should be further reduced by an additional 50% due to duplicative and overlapping relationships within and among suppliers.

[765] The environmental consultancy company commentator noted that the university group commentator estimated that there were 860,066 first tier suppliers. However, a 2008 study by the Consumer Electronics Association ("CEA") on RoHS that identified only 90,000 total electronic suppliers. In this regard, the environmental consultancy company noted that, although conflict minerals disclosure is required by more than just electronics industry issuers, "the total number of affected first-tier suppliers being over 100,000 seems unrealistic based on this more substantiated information." Also, the environmental consultancy company noted that, in many cases, first-tier suppliers may not be supplying products or components

Further, the environmental consultancy company suggested that the manufacturing industry group's cost estimate regarding issuers' information technology systems should be adjusted from \$6 billion to \$350 million and that the university group's estimate should be adjusted from \$2.56 billion to \$360 million.[766] Additionally, the environmental consultancy company asserted that the \$100,000 per company audit costs provided by both the manufacturing industry group and the university group were too high because companies' financial statement audits represent only 0.2 to 0.25% of a company's annual revenue, which would mean that a \$100,000 cost for a Conflict Minerals Report audit would represent 5% of the total audit costs for a company with a \$1 billion per year revenue. Instead, the commentator argued that it would be more accurate to assume that the Conflict Minerals Report audit would represent 1% to 2% of the total audit costs for such a company.[767] Also, the environmental consultancy company contended that only 50% of all reporting issuers would be required to provide a Conflict Minerals Report because the "majority of Energy sector, finance and utilities will not have to create" a Conflict Minerals Report, and "[n]o more than half of the consumer discretionary, consumer staples, and materials sectors is expected" to provide a

containing conflict minerals, or these products or components will represent only a small fraction of their business.

766 The environmental consultancy company commentator noted that the CEA study found that the average cost for information technology systems changes for RoHS was \$120,000 per company, and it discovered that the most expensive conflict minerals software was \$40,000 by conferring with a provider of conflict minerals compliance software to confirm that their most expensive software for conflict minerals compliance was \$40,000 for the first year.

767 In its second letter, however, the environmental consultancy company commentator acknowledged that it had limited expertise regarding estimates of the cost of third party audits. See letter from Claigan Environmental Inc. (Dec. 1, 2011) ("Claigan II").

Conflict Minerals Report.[768]

Finally, the environmental consultancy company developed its own cost model,[769] which was based on current service quotations in the industry and past costs for RoHS compliance based on the 2008 CEA study. In this regard, the commentator provided its estimate of the typical initial costs for affected issuers with revenue of $1 billion per year. Initially, in its first comment letter, the environmental consultancy company concluded that the proposal's compliance cost for a typical affected issuer with $1 billion of revenue would be approximately $315,000 per year.[770]

In a subsequent letter to us, the environmental consultancy company lowered its cost estimate.[771] Instead of the $315,000 per issuer estimate in its initial letter, the environmental consultancy company argued that the cost per issuer for compliance would be closer to $213,000 per issuer because of "more recent information on corporate

[768] See letter from Claigan I.

[769] Id.

[770] The environmental consultancy company commentator noted that the $315,000 per year cost would equate to approximately 0.03% of an issuer's revenue, but argued that, based on certain variations, the cost range could be anywhere between 0.02% and 0.05% of revenue. Id. The commentator stated further that the average cost of initial compliance with RoHS for a company with annual revenue of $1 billion was close to 0.8% of revenue. However, the commentator indicated that the data gathering and the software costs for RoHS was approximately 0.08% of the initial RoHS compliance costs, which the commentator argued was "the same order of magnitude" of its 0.03% calculation. This commentator suggested that its "slightly lower" cost projections were due to less expensive conflict minerals software packages, as compared to RoHS, and the large data gathering cost for RoHS, the need to gather data for every part and create new part numbers for compliant parts, are not required for conflict minerals. The commentator noted also that, if the final rule would cause issuers to dispose of their current conflict mineral inventories because the conflict minerals were of indeterminate origin or our rule would not exempt conflict minerals from recycled or scrap sources, the expected costs of compliance would be closer to 0.5% of revenue.[770] Finally, the commentator claimed that this initial cost of compliance is expected to increase by a factor of 2.5 for an issuer having ten times the annual revenue ($10 billion) and decrease by a factor of 2.5 for an issuer with 10% of revenue ($100 million). Id.

[771] See letter from Claigan II.

budgeting and expenditures" that "better reflect current corporate implementation strategies."[772] Further, in another letter, the environmental consultancy company lowered its cost estimate again to approximately $64,673 per issuer.[773]

### v. Other Specific Comments

One commentator, an environmental research company, discussed some of the specific cost estimates above and discussed some cost estimates it gathered through interviews with potentially affected issuers.[774] This commentator conducted a study, sponsored by Global Witness, based on interviews with executives at more than 20 global companies that ranged in size from $500 million per year in revenue to over $120 billion in annual revenue, including companies engaged in electronic components, computers, consumer health care, automotive, and retail. Also, the commentator spoke with industry associations, consulting firms, and software providers.

Generally, the commentator found that, based on its interviews, costs for complying with the provision "will vary widely with the size and complexity of

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772 Id.

773 See letter from Claigan III. In this letter, the environmental consultancy group commentator broke down the number of affected issuers by size and cost per issuer based on that size. The commentator determined that the total cost to 6,000 affected issuers would be $387,650,000, which would be $64,608 per issuer. However, because we estimated that there would be 5,994 affected issuers, we divided the $387,650,000 by 5,994 issuer to come up with $64,673 per issuer. See also letter from Assent Compliance (Dec. 19, 2011) ("Assent") (discussing the software costs to issuers for implementing Section 1502, which apparently was included as part of the overall cost calculation in the letter from Claigan III). Further, the environmental consultancy company commentator provided an additional comment letter that did not revise its cost estimate, but expanded upon differences between costing estimates it submitted and previous costing estimates submitted by the manufacturing industry association and university group commentators. See letter from Claigan IV.

774 See letter from Green II. At the end of the letter, the commentator describes itself as a "research, advisory and consulting firm focusing on clean tech, alternative energy and corporate sustainability."

companies' supply chains but seem to be manageable for all company sizes."[775] In this regard, the commentator also found that the better informed executives were regarding the Conflict Minerals Statutory Provision and its impacts on their company, the more likely they thought the costs of compliance would be manageable. The commentator stated that the largest companies with annual revenues over $50 billion would have one-time costs ranging from $500,000 to $2 million, but the companies with well-developed responsible sourcing systems may only need to spend half as much. Also, the commentator found that many smaller companies "should be able to meet their obligations for less than the cost of a full-time employee in the first year with costs declining over time."[776]

Regarding the above cost estimates by other commentators, the commentator argued that the manufacturing industry association commentator's cost estimate "significantly overstates the costs most companies will incur, especially those of updating IT systems."[777] Also, the commentator noted that the electronic interconnect industry commentator's cost estimate was overstated because the estimate included electronics manufacturing services companies, and that industry is "dominated by very large companies," which "probably account[ed] for the higher median cost estimates."[778] Further, the commentator noted of the environmental consultancy company commentator's letter that the "relative magnitude of the costs shown by the

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[775] See id.

[776] See id.

[777] See id.

[778] See id.

[environmental consultancy company commentator] estimate are aligned with what [environmental research company commentator] found in [its] interviews: that the effort to gather reliable data from supply chain partners is likely to be more costly initially than any systems changes required."[779]

Another commentator that is attempting to establish a due diligence "bag-and-tag" monitoring system in the Covered Countries asserted that the total costs incurred by local governments and industry as a whole just for the on-the-ground set-up and implementation of this system in the Covered Countries would be $52 million for the first year.[780] This commentator noted that this $52 million estimate is much higher than our $8 to $10 million estimated cost for setting up a mineral source validation scheme in the Proposing Release. Similarly, another commentator provided the February 2011 five-year plan of the organization that administers the bag-and-tag scheme.[781] The commentator noted that, according to the five-year plan, "the cost of cleanly bagged-and-tagged minerals, including taxes, will remain below the world market price."[782] Also, according to the document provided, it appears that the funding requirements for the bag-and-tag scheme, including a 10% contingency, in Eastern DRC and Rwanda will be approximately $38,971,000 from 2011 through 2015.

Also, this commentator stated that trading companies, transporters, and

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[779] See id.

[780] See letter from ITRI II.

[781] Representative Jim McDermott (Oct. 12, 2011) ("Rep. McDermott") (providing the five-year plan authored by iTSCi, the International Tin Research Institute's Tin Supply Chain Initiative, in February 2011).

[782] Id.

concentrate treatment facilities that continue to trade with the Covered Countries would incur additional costs in relation to the greatly increased levels of administration and auditing that "may amount to an additional man year," which is "approximately US$100,000 per year" per trading company, transporter, and concentrate treatment facility going forward.[783] The costs to trading companies, transporters, and concentrate treatment facilities that stop treating minerals from the Covered Countries would be less "but still of significance." The commentator estimated that these companies' costs could "perhaps be an additional half a man year," which would be approximately $50,000 per year per company. Further, this commentator indicated that smelters and processing facilities may be requested to perform an independent audit every six months or every year, which would cost these smelters and processing facilities approximately $60,000 per audit. Finally, the commentator argued that the "sum cost of new auditing requirements and increasing burden of documentation in the international supply chain may amount to a total of US$7 million per year."

A few commentators provided other, less specific cost estimates. One commentator indicated that it would require 1,400 hours in the first year working with its suppliers to implement the proposed rules and an additional 700 hours in each subsequent year to comply with the proposed rules.[784] The commentator calculated this figure by using the 450 different materials the commentator would have to research, and estimated that it would require three hours per material, which would equate to approximately

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[783] See letter from ITRI II.

[784] See letter from TriQuint I.

1,400 hours.[785] The commentator stated that this estimate did "not take into account the days and weeks that will be required to write any required reports and work with auditors." Although the commentator provided an estimate of the number of hours required to comply with the rules, it did not disclose the costs associated with its number of estimated hours. The commentator noted, however, that it is "a relatively small company, [and] these costs will be multiplied many times throughout the entire economy."

Another commentator indicated that "the initial cost for establishing record keeping processes, staffing, and identifying the contacts throughout the supply chain will run approximately [four times] the on-going annual staffing [and] cost for certification."[786] In addition, this commentator asserted that the "software to track and retain these records for [five to ten] years could add another [two times] the annual cost for certification."[787] Ultimately, although the commentator did not disclose the actual costs associated with its estimates, it concluded that complying with the proposed rules would be "very expensive" for even one year.

Another commentator argued that the costs of the proposed rules to implement the statute would be expensive even for an issuer with existing systems in place to track inputs in the supply chain because such an issuer would still have to add capability to its existing systems, provide additional supplier training, and revise its existing information

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785 Id. The commentator did not provide a similar breakdown of its calculation regarding its 700 hour per subsequent year estimate.

786 See letter from Teggeman.

787 See id.

technology systems.[788] A few commentators noted Apple Inc.'s Supplier Responsibility 2011 Progress Report.[789] As one of these commentators noted, Apple investigated the use of extractives at all levels of its supply base and mapped its supply chain to the smelter level to know which of its suppliers are using tantalum, tin, tungsten, or gold and from where they are receiving the metal.[790] Accordingly, Apple determined that it has a total of 142 suppliers of conflict minerals.[791] Some commentators asserted that the costs of the proposed rules could be disproportionally higher to smaller issuers.[792] Other commentators asserted that the Proposing Release failed to account for the costs to non-issuers, which would be significant.[793]

Other commentators asserted also that the $25,000 estimated audit cost is not the correct cost for the type of audit that would be required.[794] One such commentator noted that the "cost of an independent auidit [sic] of $25,000 is also not specifically for the type of audits that would be required either on the upstream supply chain, or at the smelters."[795] Another commentator stated that we "did not specify the scope of the

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788 See letter from Ford.

789 See, e.g., letters from Enough Project I (citing to Apple Inc.'s Supplier Responsibility 2011 Progress Report at http://images.apple.com/supplierresponsibility/pdf/Apple_SR_2011_Progress_Report.pdf), Enough Project IV, and Fafo (citing to http://images.apple.com/supplierresponsibility/pdf/Apple_SR_2011_Progress_Report.pdf).

790 See letter from Enough Project I.

791 See letters from Enough Project IV and Fafo.

792 See letter from Howland.

793 See letters from NAM I and WGC II.

794 See letters from CTIA, ITRI I, and KPMG.

795 See letter from ITRI I.

independent private sector audit of the Conflict Minerals Report" in the Proposing Release, and our $25,000 estimate would correspond only to an audit of whether the issuer's Conflict Minerals Report accurately describes the due diligence the issuer exercised.[796] According to this commentator, this cost estimate, however, could be far higher depending on the audit scope to be outlined in the final rule. A further commentator indicated that our assumptions about the scope and objective of the audit in the Proposing Release were not clear, but it appeared that the estimate "may depend on a company relying on an industry-wide due diligence process and that company being able to conclude that its conflict minerals did not originate in a DRC country."[797] This commentator stated that it was not aware of any such industry-wide due diligence process in place.

### C. Benefits and Costs Resulting from Commission's Exercise of Discretion

As discussed in detail in Section II, we have revised the rules from the Proposing Release to address comments we received while remaining faithful to the language and intent of the statute as adopted by Congress. In addition to the statutory benefits and costs noted above, we believe that the use of our discretion in implementing the statutory requirements will result in a number of benefits and costs to issuers and users of the conflict minerals information. Below, we discuss the most significant choices we made in implementing the statute and the associated benefits and costs. We are unable to quantify the impact of each of the decisions we discuss below with any precision because

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[796] See letter from CTIA.

[797] See letter from KPMG.

reliable, empirical evidence regarding the effects is not readily available to the Commission, and commentators did not provide sufficient information to allow us to do so. Thus, in this section, our discussion on the costs and benefits of our individual discretionary choices is qualitative. Later in the release, we present a quantified analysis on the overall costs and benefits of the final rule that includes all aspects of the implementation of the statute.

**1. Reasonable Country of Origin Inquiry**

The Conflict Minerals Statutory Provision requires any issuer with necessary conflict minerals that "did originate" in the Covered Countries to provide a Conflict Minerals Report.[798] The provision, however, does not specify how an issuer is to determine whether its conflict minerals originated in the Covered Countries. The provision states only that any issuer with such conflict minerals must submit a report to us that describes, among other matters, the measures taken by the issuer to determine the source and chain of custody of those conflict minerals.

We used our discretion in the final rule to require that issuers covered by Section 1502 of the Act conduct a good faith "reasonable country of origin inquiry" that is reasonably designed to determine whether their conflict minerals originated in the Covered Countries or are from recycled or scrap sources. We do not specify what would constitute a "reasonable country of origin inquiry." We believe that this decision to employ a performance standard rather than a design standard should benefit issuers by allowing them the flexibility to use the reasonable country of origin inquiry standard that

[798] Exchange Act Section 13(p)(1)(A).

is best suited to their circumstances.

Although the final rule does not specify what would constitute a reasonable country of origin inquiry, it requires that the issuer conduct in good faith an inquiry that is reasonably designed to determine whether any of its conflict minerals originated in the Covered Countries or came from recycled or scrap sources. Although the proposal did not state explicitly that an issuer must reasonably design its inquiry and conduct it in good faith, we believe that this is not a change from the proposal, but a clarification of the proposal's intent. We believe providing this clarification will facilitate compliance with the rule by providing further guidance to issuers about what is required to satisfy the reasonable country of origin inquiry. Other than being reasonably designed and performed in good faith, however, the final rule does not require issuers to conduct an exhaustive inquiry to establish to a certainty whether their conflict minerals originated in Covered Countries or came from recycled or scrap sources. We believe this is appropriate because, under the Conflict Minerals Statutory Provision, issuers are required to ascertain whether their conflict minerals did originate in the Covered Countries to know whether they must submit a Conflict Minerals Report. Therefore, some inquiry is necessary.

We could have required an issuer to exercise due diligence in determining whether its conflict minerals originated in the Covered Countries or came from recycled or scrap sources. We also could have required an exhaustive inquiry in which an issuer would be required to determine to a certainty whether each mineral originated in the Covered Countries. However, while these would be plausible alternatives, such inquiries likely would be more costly, and we do not believe those approaches are necessary.

Instead, we believe the reasonable country of origin inquiry standard provides a clear way for issuers to make the necessary determination and does so in a more cost-effective manner. The reasonable country of origin inquiry is consistent with the supplier engagement approach in the OECD guidance where issuers use a range of tools and methods to engage with their suppliers.[799] The results of the inquiry may or may not trigger due diligence. This is the first step issuers take under the OECD guidance to determine if the further work outlined in the OECD guidance – due diligence – is necessary. The Conflict Minerals Statutory Provision specifically contemplates due diligence, which goes beyond inquiry and involves further steps to establish the truth or accuracy of relevant information, by requiring a description of the measures the issuer took to exercise due diligence on the source and chain of custody of the minerals. The Conflict Minerals Statutory Provision specifically notes that due diligence includes the audit discussed below.

We recognize that our reasonable country of origin approach is broad enough that some issuers might perform an insufficiently rigorous inquiry and some issuers might perform an overly rigorous inquiry. An insufficiently rigorous inquiry could result in an erroneous determination that the issuer is not required to submit a Conflict Minerals Report, thus reducing the utility of the disclosure with respect to the issuer's use of conflict minerals. An overly rigorous inquiry, on the other hand, could cause issuers to

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[799] In June 2012, the OECD issued a report regarding implementation of the OECD guidance. See OECD, DOWNSTREAM IMPLEMENTATION OF THE OECD DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS, CYCLE 2 INTERIM PROGRESS REPORT ON THE SUPPLEMENT ON TIN, TANTALUM, AND TUNGSTEN FINAL DRAFT (June 2012), available at http://www.oecd.org/investment/guidelinesformultinationalenterprises/Downstream%20cycle%202%20report%20-%20Edited%20Final%20-%201%20June.pdf. This additional guidance includes sample letters to suppliers and customers regarding the use of conflict minerals.

incur greater costs than they would otherwise. We believe, however, that the requirement that issuers make certain disclosures about the particular reasonable country of origin inquiry they undertook mitigates concerns about an insufficiently rigorous inquiry. Similarly, we believe our guidance that issuers need only conduct an inquiry reasonably designed to determine whether conflict minerals originated in the Covered Countries mitigates concerns about an overly rigorous inquiry. Overall, we believe that the benefit of mitigating issuer compliance costs justifies the "reasonable country of origin" approach we have chosen.

Also, in a change from the proposal, the final rule establishes a different standard for the issuer in determining, based on its reasonable country of origin inquiry, whether due diligence on the conflict minerals' source and chain of custody and a Conflict Minerals Report is required. The proposed rules would have required an issuer to conduct due diligence and provide a Conflict Minerals Report, based on its reasonable country of origin inquiry, if, among other conclusions, the issuer was unable to determine that its conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources. Under the proposal, issuers could only avoid providing a Conflict Minerals Report if they could prove a negative – that their conflict minerals did not originate in the Covered Countries. That approach would arguably have been more burdensome than necessary to accomplish the purpose of the statutory provision.

Under the final rule, however, an issuer must exercise due diligence on its conflict minerals' source and chain of custody and potentially provide a Conflict Minerals Report if the issuer knows that its necessary conflict minerals originated in the Covered Countries and did not come from recycled or scrap sources, or has reason to believe that its necessary conflict minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources. This new approach does not require an issuer to prove a negative to avoid performing due diligence, but it also does not allow an issuer to ignore warning signs or circumstances reasonably indicating that its conflict minerals may have originated in the Covered Countries or may not have been from recycled or scrap sources. This approach should reduce the total costs of the final rule, by enabling an issuer that, following a reasonable country of origin inquiry, is unable to determine that its conflict minerals did not originate in the Covered Countries or come from recycled or scrap sources, but has no reason to believe that its necessary conflict minerals may have originated in the Covered Countries or do not come from recycled or scrap sources, to fully comply with the rule without conducting due diligence, obtaining an audit, or preparing and filing a Conflicts Mineral Report.

We realize that requiring a Conflict Minerals Report if, after exercising a reasonable country of origin inquiry, the issuer has reason to believe that it has necessary conflict minerals that may have originated in the Covered Countries and may not have come from recycled or scrap sources will be more costly than only requiring a report if the issuer has affirmatively determined that its minerals did come from the Covered Countries. However, as already discussed, we believe that such an approach is required to achieve the benefits intended by the statute. Moreover, this approach provides an appropriate balance compared to the more costly possible approach of requiring an issuer to submit a Conflict Minerals Report unless it determines to a certainty that its necessary conflict minerals did not originate in the Covered Countries.

This approach regarding when an issuer must exercise due diligence as to the source and chain of custody of its conflict minerals and provide a Conflict Minerals Report could increase costs of the final rule. Some issuers may expend more resources than necessary to satisfy the standard in order to assure themselves that their minerals did not originate in the Covered Countries. On the other hand, other issuers may expend insufficient resources which could lead to inadequate inquiries. However, we anticipate that overall this approach will result in fewer issuers engaging in due diligence and providing a Conflict Minerals Report because, although an issuer may not be able to determine to a certainty, even after a reasonable country of origin inquiry, that its conflict minerals did not originate in the Covered Countries or are from recycled and scrap sources, that issuer may have no reason to believe that its necessary conflict minerals may have originated in the Covered Countries and not come from recycled or scrap sources. This situation will reduce costs to such issuers because those issuers are not required to exercise due diligence and provide a Conflict Minerals Report.

In a further change from the proposal, the final rule requires an issuer that determines that, following its reasonable country of origin inquiry, its conflict minerals did not originate in the Covered Countries or come from recycled or scrap sources or has no reason to believe that its necessary conflict minerals may have originated in the Covered Countries or did not come from recycled or scrap sources to provide a brief description of the results of that inquiry. The proposal required issuers to disclose their reasonable country of origin inquiry and their determination based on that inquiry. Compared to an alternative that does not require such description, this requirement will increase the disclosure costs to issuers. However, the disclosure will enable users of the information to assess more thoroughly the issuer's reasonable country of origin design and its efforts in carrying out that design. This information will allow stakeholders to form their own views on the reasonableness of the issuer's efforts and track those efforts over a number of years. Based on this information, stakeholders could advocate for different processes for individual issuers if they believe it is necessary, thereby maximizing the potential benefits of the performance-based approach we are adopting.

Additionally, we revised the final rule from the proposal so that, following its reasonable country of origin inquiry, an issuer that determines its conflict mineral did not originate in the Covered Countries is not required to keep reviewable records for five years. We believe this decision should benefit issuers by allowing them greater flexibility and by reducing their compliance costs because they no longer have a record retention cost, which should reduce the overall costs involved as compared to the other possible methods of implementing the statute.

**2. Information in the Specialized Disclosure Report**

We revised the final rule from the proposal so that an issuer that must file a Conflict Minerals Report is not required to disclose, in its specialized disclosure report under a separate "Conflict Minerals Disclosure" heading, the reason it is filing its Conflict Minerals Report. Similarly, the final rule does not require an issuer to disclose in its specialized disclosure report that it has provided an audit report or a certification of the audit because the audit report and certification are part of the Conflict Minerals Report already, so specifically mentioning the audit report or certification here is not necessary and may be confusing. Instead, the issuer must only disclose that a Conflict Minerals Report is provided as an exhibit to its specialized disclosure report and a link to its Internet website where the Conflict Minerals Report is publicly available. We believe these decisions should benefit issuers by not requiring them to provide as much disclosure in the specialized disclosure report, which should reduce the costs involved as compared to the other possible methods of implementing the statute. However, we do not believe that such decisions will reduce the benefits to be achieved by the final rule, because the information that the proposal required to be disclosed in the specialized disclosure report is already provided in the Conflict Minerals Report, which is required to be filed as an exhibit to Form SD.

### 3. "DRC Conflict Undeterminable" Determination

The final rule temporarily permits issuers to describe their products as "DRC conflict undeterminable" if they are required to file a Conflict Minerals Report and are either unable to determine that their conflict minerals did not originate in the Covered Countries or are unable to determine that their conflict minerals that originated or may have originated in the Covered Countries did not directly or indirectly benefit or finance armed groups in the Covered Countries. An issuer with products that are "DRC conflict undeterminable" is required to exercise due diligence on the source and chain of custody of its conflict minerals and submit a Conflict Minerals Report describing the due diligence, the country of origin of the conflict minerals, if known, the facilities used to process the conflict minerals, if known, and the efforts to determine the mine or location of origin with the greatest possible specificity. Also, such an issuer is required to describe its products containing these conflict minerals as "DRC conflict undeterminable," rather than stating that they have not been found to be "DRC conflict free." An issuer with such conflict minerals, however, is not required to obtain an independent private sector audit of that Conflict Minerals Report. This reporting alternative is temporary and will be available only during the first two reporting cycles following the effectiveness of the final rule for all issuers, which includes the specialized disclosure reports for 2013 and 2014, and the first four reporting cycles following the effectiveness of the final rule for smaller reporting companies, which includes the specialized disclosure reports for 2013 through 2016. After these times, an issuer unable to determine that its conflict minerals did not originate in the Covered Countries or unable to determine that its conflict minerals that originated or may have originated in the Covered Countries did not directly or indirectly finance or benefit armed groups in the Covered Countries must describe its products containing those minerals as having not been found to be "DRC conflict free" and provide an independent private sector audit of its Conflict Minerals Report.

This temporary provision will have the benefit of lowering the initial costs of the rule both because an audit will not be required and because, to the extent issuers suffer negative consequences from disclosure that their products have not been found to be "DRC conflict free," those consequences would likely not be as significant for an issuer that is able to disclose that it has conducted due diligence on its conflict minerals and not found a connection to armed groups. We believe that not requiring an independent private sector audit of the Conflict Minerals Report during this temporary period is appropriate because an audit of the design of an issuer's due diligence that results in an undeterminable conclusion would not appear to have a meaningful incremental benefit. Also, we recognize the concerns about the feasibility of preparing the required disclosure in the near term because of the stage of development of the supply chain tracing mechanisms. We adopted this temporary provision to allow sufficient time for more comprehensive tracking systems to be developed by industry and trade groups. The development and use of such comprehensive tracking systems should improve due diligence performance and lower the cost of compliance with the statute by reducing duplication and taking advantage of economies of scale. We believe that a two-year period for issuers with an indeterminate conclusion is appropriate because this appeared to be the approximate amount of time that many commentators stated would be necessary to establish traceability systems in the Covered Countries.[800] Also, we believe that a four-year period for smaller reporting companies with an indeterminate conclusion is appropriate because they may have fewer resources to implement the final rule and may lack the leverage to obtain detailed information regarding the source of a particular conflict mineral.[801]

Issuers that are unable to determine, following their exercise of due diligence, that their conflict minerals did not originate in the Covered Countries; that their conflict minerals that originated in the Covered Countries did not directly or indirectly finance or benefit armed groups in the Covered Countries; or, after their exercise of due diligence, are unable to determine that their conflict minerals came from recycled or scrap sources are required to file a Conflicts Minerals Report describing, among other matters, the due diligence they exercised and the steps they have taken or will take, if any, since the end of the period covered in their most recent prior Conflict Minerals Report to mitigate the

800 See, e.g., letters from AdvaMed I, FEC I, JVC et al. II, Plexus, Verizon, and WilmerHale.

801 Using the cost of audit estimates provided by the university group and the manufacturing industry group commentators, which we also use below, we estimate that this exercise of discretion by the Commission would reduce the initial compliance cost of a small issuer by approximately $25,000 and the initial compliance cost of a large issuer by approximately $100,000 per year for each year of the applicable temporary period based upon the analysis of the university group commentator.

risk that their necessary conflict minerals benefit armed groups, including any steps to improve their due diligence. After the transition period, such issuers will be required to include an independent private sector audit of their Conflict Minerals Reports with respect to those minerals, which is likely to increase costs for those issuers. One commentator argued that "Section 1502 does not require an issuer that has been unable to determine (after a proper inquiry) the source of its conflict minerals…to provide a Conflict Minerals Report."[802] As discussed above, we believe the process that better reflects the statutory intent is as follows:

- an issuer that, following a reasonable country of origin inquiry, has reason to believe that its necessary conflict minerals may have originated in the Covered Countries, and may not be from recycled or scrap sources, must conduct due diligence on the source and custody of such conflict minerals, in accordance with a nationally or internationally recognized due diligence framework, and
- if, following such due diligence, such issuer is unable to determine that such conflict minerals did not originate in the Covered Countries (and is unable to determine that such conflict minerals are from recycled or scrap sources), then such issuer is required to submit a Conflict Minerals Report.

While this approach may add to the overall costs of compliance, we do not believe the alternative reading suggested by commentators is consistent with the purposes of the statute. The final rule's temporary provision for "DRC conflict undeterminable" products, however, is designed to reduce compliance costs during the transition period.

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802 See letter from Cleary Gottlieb.

### 4. "Contract to Manufacture"

As discussed above, the final rule applies to issuers that contract to manufacture products. This requirement is based on our interpretation of the statute in light of our understanding of the statutory intent and a reading of the statute's text. We recognize that this approach affects the overall compliance costs and burdens, in particular, on the subset of issuers that contract to manufacture products. However, we have sought to mitigate these costs by not defining the term "contract to manufacture" in the final rule, and instead letting issuers determine based on their own facts and circumstances which of their products have conflict minerals that may trigger a reporting obligation.

Compared to the alternative approach of defining this term, our decision not to define the term provides issuers with significant flexibility to use a definition that applies best to their particular circumstances. Such flexibility may lower issuers' compliance costs to the extent any definition could have been overbroad. But, we also recognize that our decision not to define this phrase could increase uncertainty for issuers on how the phrase should be implemented and may result in additional costs to some issuers. For example, the uncertainty associated with leaving the phrase undefined could lead some issuers to interpret the definitions in a manner that is more expansive than if the phrase was defined, thus incurring a higher compliance cost than is necessary. In this regard, some issuers may decide to use more internal or external resources than if this phrase was defined to make sure they are compliant with the rule, which would also increase compliance costs. The lack of a clear definition could also result in a diminishment of the benefit if some issuers are less rigorous in determining and reporting on their products that have conflict minerals, which would reduce the utility of their disclosure. Overall, however, we believe the potential benefit of flexibility outweighs the potential increases in costs.

In the proposal, we expressed our view that an issuer that does not manufacture a product itself but that has "any" influence over the product's manufacturing should be considered to be contracting to manufacture that product. Also, we expressed our view that an issuer that offers a generic product under its own brand name or a separate brand name should be considered to be contracting to manufacture that product so long as the issuer had contracted to have the product manufactured specifically for itself. As noted in the Proposing Release, we had believed that these issuers should have been considered to be contracting those products to be manufactured because the issuers would implicitly influence the manufacturing of the products. However, we are persuaded by commentators that this level of control set forth in the Proposing Release was "overbroad" and "confusing" and would impose on such an issuer "significant," "unrealistic," and "costly" burdens.[803] Therefore, we provide guidance indicating that an issuer is considered to be contracting to manufacture a product depending on the degree of influence it exercises over the materials, parts, ingredients, or components to be included in any product as well as examples. We believe that this guidance may decrease issuers' flexibility for some issuers, but it will provide more certainty for others.

### 5. Nationally or Internationally Recognized Due Diligence Framework (Including Gold)

[803] See, e.g., letters from ABA, AT&T, Corporate Secretaries I, Davis Polk, and Verizon. See also letter from NRF I (stating that our proposed approach would be "draconian").

Although Exchange Act Section 13(p)(1)(A)(i) requires issuers to describe the measures taken to exercise due diligence, the provision does not indicate the due diligence required. The final rule's requirement that issuers use a nationally or internationally recognized due diligence framework in their Conflict Minerals Reports may result in a certain degree of standardization in the preparation of the disclosure and may reduce audit costs by focusing the audit. To the extent issuers tend to use the same due diligence framework, this standardization will benefit users of the information by making the Conflict Minerals Reports easier to compare, thus reducing costs for users of comparing information across issuers.

Also, requiring a nationally or internationally recognized due diligence framework allows us to provide a clear audit objective that includes whether the design of an issuer's due diligence measures is in conformity with the criteria set forth in the nationally or internationally recognized due diligence framework and whether an issuer's description of the due diligence measures it performed is consistent with the due diligence process it undertook. As discussed below, having a clear audit objective based on the design of an issuer's due diligence framework lowers audit costs compared with a rule that does not require a specified framework because it focuses the scope of the audit that must be performed and, therefore, makes the audit less time-consuming and less costly.

Further, the final rule requires that an issuer's due diligence follow a nationally or internationally recognized due diligence framework that is established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment, and is consistent with the criteria standards in GAGAS established by the GAO. This requirement improves the credibility and usefulness of the reports. Also, requiring adherence to a nationally or internationally recognized due diligence framework will provide issuers with a degree of certainty that their due diligence process is reliable and will pass a regulatory review. However, this requirement also will limit the issuer's flexibility in determining the source of origin and chain of custody of their conflict minerals. If the established requirement is more burdensome than what the issuer might have otherwise considered sufficient due diligence, it might make it more costly for issuers compared to using a due diligence process based on their own facts and circumstances.

**6. Liability for the Audit and Audit Certifications**

Exchange Act Section 13(p)(1)(A)(i) requires the independent private sector audit to be conducted in accordance with the standards established by the GAO. Exchange Act Section 13(p)(1)(B) states that the issuer must certify the audit and that certified audit constitutes a critical component of due diligence.[804] Under the final rule, an issuer's audit certification is in the form of a statement in the Conflict Minerals Report that the issuer

[804] As noted elsewhere in this release, the staff of the GAO has indicated to our staff that the GAO does not intend to publish standards for the independent private sector audit and that GAGAS' Performance Audit or Attestation Engagement standards can be used for these audits. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-331G, GOVERNMENT AUDITING STANDARDS 2011 REVISION (Dec. 2011), available at http://www.gao.gov/assets/590/587281.pdf. Therefore, to conduct an independent private sector audit, an auditor must comply with certain quality control procedures and peer reviews, which are required under the GAGAS Performance Audit and Attestation Engagement standards. The GAGAS Attestation Engagement standards, in Chapter 3.75, require that auditors be "licensed certified public accountants, persons working for a licensed certified public accounting firm or for a government auditing organization, or licensed accountants in states that have multi-class licensing systems that recognize licensed accountants other than certified public accountants." Unlike the GAGAS Attestation Engagement standard, the GAGAS Performance Audit standard allows auditors other than certified public accountants to perform a Performance Audit, provided the auditor complies with the applicable qualification requirements under GAGAS, which will increase the number of firms eligible to conduct the private sector audits. Increasing the number of firms that are eligible to conduct the independent private sector audits should increase competition, which should make it less costly for an issuer to obtain such an audit.

obtained an independent private sector audit. This should benefit issuers by not subjecting individuals employed by the issuer to liability for the information in the Conflict Minerals Report or the audit. Additionally, the final rule does not require an auditor to assume expert liability regarding the audit because the audit report would not be incorporated by reference or otherwise included in Securities Act filings. Therefore, depending on the state of competition in the market for independent private sector audits, not requiring the assumption of such liability may result in lower audit fees, which in turn should decrease conflict minerals reporting companies' cost of compliance with the statute. However, not requiring the certification to be signed by an officer and not requiring an auditor to assume expert liability could decrease the benefits of the rule if it results in issuers taking less care in their certifications and auditors conducting less thorough audits.

**7. Audit Objective**

The final rule provides a clear audit objective. We believe that the audit is meaningful because investors and other users will have some assurance from an independent third party that the issuer's due diligence framework, as set forth in the Conflict Minerals Report, is designed in conformity with the relevant nationally or internationally recognized due diligence framework, and that the issuer actually performed the due diligence measures that it represents that it performed in the Conflict Minerals Report. We recognize that an audit objective requiring an auditor to express an opinion or conclusion as to the design and description of an issuer's due diligence measures is not as comprehensive as an audit objective requiring an auditor to express an opinion or conclusion as to the effectiveness of due diligence measures or the accuracy of conclusions in the Conflict Minerals Report. However, we believe that the audit will still be meaningful because it will provide some assurance from an independent third party that the issuer's due diligence framework is designed in conformity with the relevant nationally or internationally recognized due diligence framework and that the issuer actually performed the due diligence measures as they were described.

With respect to what audit objective is appropriate, we considered the following possible audit objective alternatives from commentators: whether management's description of procedures and controls performed in their due diligence process are fairly described in the report; whether an issuer's design of its due diligence process described in the report conformed to a recognized standard of due diligence; whether management's description of an issuer's due diligence process in its report is accurate, the results of that process are fairly stated, and the issuer has evaluated/identified the upstream and downstream due diligence processes; whether the design of the due diligence process described in the report conformed to a recognized standard and whether the process was effective; whether the issuer's conclusion regarding the source and chain of custody of its conflict minerals is accurate; and whether the issuer appropriately included in the report all its products described as having not been found to be "DRC conflict free." We used our discretion to make the audit objective in the final rule similar to the first and second alternatives with some modification. The final rule states that the objective of the independent private sector audit is for the auditor to express an opinion or conclusion as to whether the design of the issuer's due diligence measures as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is in conformity with, in all material respects, the criteria set forth in the nationally or internationally recognized due diligence framework used by the issuer, and whether the issuer's description of the due diligence measures it performed as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is consistent with the due diligence process that the issuer undertook.

We believe that our choice of audit objective in the final rule will reduce the costs and burdens more than certain other alternatives. However, we recognize that the audit objective will not reduce the costs and burdens as much as if the audit objective required only an opinion or conclusion as to whether the design of the issuer's due diligence measures is in conformity with the criteria set forth in the nationally or internationally recognized due diligence framework. We believe an audit related to whether the issuer actually performed the due diligence measures that it represents that it performed in the Conflict Minerals Report is necessary and appropriate so that the audit also addresses, in a cost effective manner, the actual performance of the due diligence and not just the design as well as provide independent third party confirmation that the work described was performed. Based on the comments we received, however, an audit objective based on any of the alternatives other than just the design of the issuer's due diligence measures and the issuer's description of the due diligence measures it performed would be very costly and burdensome to undertake due to the breadth of those alternatives and the fact that most of the evidence required for those alternatives would be held by third party suppliers and smelters.

**8. Conflict Minerals from Recycled or Scrap Sources**

The Conflict Minerals Statutory Provision is silent as to the treatment of conflict minerals from recycled or scrap sources. In the final rule, however, we provided for alternative treatment for conflict minerals from recycled or scrap sources. The alternative reporting requirements for conflict minerals from recycled or scrap sources should benefit issuers by reducing issuers' compliance costs with the disclosure requirements in Section 1502 because those issuers will conduct a reasonable inquiry regarding whether those minerals are from recycled or scrap sources instead of having to exercise due diligence and provide a Conflict Minerals Report in all cases. Also, issuers that, following a reasonable inquiry conducted in good faith, reasonably believe their minerals are from recycled or scrap sources will not have to obtain an independent private sector audit. A reduction in costs of not having to exercise due to diligence or obtain an independent private sector audit is likely to be significant for those industries that use a high concentration of conflict minerals that are from recycled or scrap sources.[805]

The final rule requires issuers with conflict minerals that have reason to believe their conflict minerals may not come from recycled or scrap sources to exercise due diligence in determining whether the minerals are, in fact, from recycled or scrap sources. That due diligence must follow a nationally or internationally recognized due diligence framework, if such framework is available. While providing a higher degree of certainty that those conflict minerals came from recycled or scrap sources, the requirement will also increase the costs to issuers, compared to an alternative that would allow issuers to rely on their own due diligence approach to verify that these minerals are from recycled or scrap sources. Eliminating the requirement of an independent private sector audit of

[805] We are unable to estimate the total magnitude of these cost savings because we do not have empirical evidence regarding the scope of the use of conflict minerals that are from recycled or scrap sources. See below Section D for a further analysis of the potential costs of this provision.

their Conflict Minerals Report, however, could potentially decrease costs to issuers.

We believe that the magnitude of the cost savings for issuers with conflict minerals from recycle or scrap sources will be greatest for companies that use exclusively scrap and recycled materials. Although we did not receive any information from commentators as to the number of companies that may fall into this category, a number of commentators stated that the use of conflict minerals from recycled or scrap sources is significant. For example, some commentators noted that China controls approximately 85% of the world's tungsten supply, but China is cutting back on tungsten exports, which is causing the price of tungsten to increase by 130%.[806] According to these commentators, this development has caused American manufactures to move to recycled tungsten, which represented approximately 55% of apparent consumption of tungsten in all forms. Also, as another example, one commentator noted that up to 40% of the world's gold supply is from recycled or scrap sources.[807] Even so, issuers that use both conflict minerals from recycled or scrap sources and newly mined minerals may still need to exercise due diligence and obtain an audit regarding the conflict minerals that are not from recycled or scrap sources and thus, may not have significant additional cost savings. Overall, however, even with these requirements, we believe that providing an alternative treatment for conflict minerals from recycled or scrap sources should benefit issuers by reducing their compliance costs for those minerals as compared with the costs applicable to newly mined conflict minerals. Moreover, an indirect consequence of our differential

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806 See, e.g., letters from Rep. Altmire, Rep. Murphy, Rep. Renacci, Rep. Shuster, Rep. Toomey, Rep. Womack, and Sen. Pryor.

807 See letter from WGC II.

treatment of scrap and recycling materials may be to increase the extent to which these materials are recycled. Finally, the reasonable country of origin inquiry requirements are likely to improve the disclosures regarding conflict materials from recycled or scrap sources.

**9. Conflict Minerals "Outside the Supply Chain"**

Like conflict minerals from recycled and scrap sources, the Conflict Minerals Statutory Provision is silent as to the treatment of conflict minerals "outside the supply chain" at the time our final rule takes effect, including existing stockpiles of conflict minerals. However, in the final rule we have determined to exclude any conflict minerals that are "outside the supply chain" prior to January 31, 2013. The final rule considers conflict minerals to be "outside the supply chain" after such conflict minerals have been smelted (in the case of tantalum, tin, or tungsten) or refined (in the case of gold), or, if not smelted or refined, are physically located outside of the Covered Countries.

We are aware of the concern that these existing stockpiles could have come from activities that financed or benefited armed groups in the Covered Countries. However, once those minerals have been smelted, refined, or transported out of the Covered Countries, it seems unlikely that they could further finance or benefit armed groups. Therefore, we believe excluding these stockpiled minerals would be consistent with the statutory intent of the Conflict Minerals Statutory Provision and does not significantly impair the benefits sought by the statute. Moreover, the approach we have chosen may substantially reduce compliance costs for some issuers by not requiring them to determine the origin and chain of custody of these stockpiled minerals. An alternative approach that requires issuers to determine the origin and chain of custody of their stockpiled minerals would greatly increase costs, particularly for conflict minerals that were extracted prior to the contemplation of the Conflict Minerals Statutory Provision because issuers would not have known they were expected to determine the origin of those minerals at the time of their extraction. Further, if stockpiled minerals were not excluded, issuers might not be able to sell those minerals and could be forced to dispose of their existing conflict minerals inventory at below market prices, or at a loss. If such a situation occurred, as one commentator noted, the cost of the final rule would increase "dramatically."[808]

### 10. Conflict Mineral Derivatives

The Conflict Minerals Statutory Provision defines the term "conflict mineral" as cassiterite, columbite-tantalite, gold, wolframite, or their derivatives, or any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the Covered Countries.[809] The Proposing Release provided the same definition of the term "conflict mineral" as well. In the final rule, however, we used our discretion to limit the term "conflict mineral" to include only cassiterite, columbite-tantalite, gold, wolframite, and their derivatives, which are limited to only the 3Ts, unless the Secretary of State determines that additional derivatives are financing conflict in the Covered Countries, in which case they are also considered "conflict minerals." By using our discretion to limit the covered mineral derivatives, we could be limiting the usefulness of

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[808] See letter from Claigan I.

[809] Section 1502(e)(4) of the Act. Presently, the Secretary of State has not designated any other mineral as a conflict mineral. Therefore, the conflict minerals include only cassiterite, columbite-tantalite, gold, wolframite, or their derivatives.

the information of the conflict minerals disclosure. This potential disadvantage is mitigated, however, by the fact that tantalum, tin, and tungsten are by far the most common derivatives of these minerals.[810] A different approach would increase costs to issuers by increasing the number of derivatives that they would have to determine are in their products.

### 11. Method and Timing of Disclosure on Form SD

Exchange Act Section 13(p)(1)(A) requires issuers to "disclose annually" their conflict minerals information, but does not specify how issuers should disclose this information or at what time during the year the disclosure must be provided. The final rule requires issuers to provide this information annually in a new, specialized disclosure report on new Form SD that covers a calendar year, regardless of the issuer's fiscal year end, and is due on May 31 of the subsequent year. Our decision to provide through rulemaking that issuers use the new form for the disclosure of conflict minerals' origin and the Conflict Minerals Report makes it easier for those interested in the disclosed information to locate the form. In addition, the final rule requires that issuers present the information in a standardized manner. Users that find the information about an issuer's conflict minerals relevant to their decision making will benefit from the standardization and simplification of the disclosure.

Further, requiring issuers to use a new form with a uniform filing date rather than submitting conflict minerals information in their annual reports would benefit most issuers by allowing them to have sufficient time to prepare and file their conflict minerals

[810] See letters from AAFA, ITIC I, and PCP.

information independent from the due dates for annual reports.[811] Moreover, we believe that this staggered filing date will benefit issuers because they could, if they choose to do so, use the same personnel to handle this filing as their annual reports. Another benefit for issuers of requiring issuers to provide their conflict minerals information on a new form, instead of an annual report on Form 10-K, Form 20-F, or Form 40-F, is to remove the conflict minerals information from the disclosure that principal executive and financial officers must certify under Sections 302 and 906 of Sarbanes-Oxley, which could reduce costs to issuers. Also, requiring a uniform reporting period for all issuers will benefit companies that supply products or components with conflict minerals by allowing them to provide reports once per year for all their customers, rather than having to prepare reports throughout the year for customers with different reporting periods, which will reduce such companies' costs.

Our decision to require a new form will result in costs related to the preparation of this form, as we discuss below in the Paperwork Reduction Act section. Also, our decision to require an issuer to provide its Conflict Minerals Report and its independent private sector audit report as an exhibit to its specialized disclosure report on Form SD will result in costs related to the preparation of such an exhibit.

Requiring covered issuers to file, instead of furnish, their Conflict Minerals Reports gives investors the ability to bring suit if issuers fail to comply with the new disclosure requirements, for instance under Exchange Act Section 18. This may, therefore, potentially improve the avenues of redress available to investors. This, in turn,

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811 We estimate that almost 58% of total number of affected issuers uses December 31 as a fiscal year end.

may provide benefits to investors to the extent they rely on the information to make investment decisions. Because this could improve investors' ability to seek redress, it is possible that covered issuers could be found liable for the disclosure. Our decision to require issuers to "file," rather than "furnish," the information will potentially subject issuers to litigation under Section 18 and may "incentivize issuers (and auditors and underwriters) to conduct an appropriate level of diligence" in preparing the disclosures,[812] thereby increasing issuers' cost of complying with the final rule.[813] In addition, our decision to require a uniform reporting period could further increase costs to issuers that do not have calendar year fiscal years by requiring separate reporting outside of the issuer's normal reporting period.

**12. "Necessary to the Functionality or Production"**

Exchange Act Section 13(p)(2)(B) defines a "person described" as one for which conflict minerals are "necessary to the functionality or production of a product manufactured by such a person." The Conflict Minerals Statutory Provision, however, provides no additional explanation or guidance as to the meaning of "necessary to the functionality or production of a product." We use our discretion not to define this phrase in the final rule.

Compared to an alternative of the rule, which would define this phrase, our

[812] See letter from Global Witness I.

[813] While the increased potential for litigation may increase costs, we note that Section 18 claims have not been prevalent in recent years and a plaintiff asserting a claim under Section 18 would need to meet the elements of the statute, including materiality, reliance, and damages. See Louis Loss and Joel Seligman, Ch. 11 "Civil Liability," Subsect. c "False Filings [§ 18]," Fundamentals of Securities Regulation (3rd Ed. 2005). We are unable to estimate the magnitude of this potential cost increase because we cannot predict at this time whether Section 18 claims will increase (and if so, by how much) and how costly it may be to ultimately prove the required elements or defend such a case.

decision not to provide a definition gives issuers significant flexibility to use a definition that applies best to their particular circumstances. Such flexibility generally lowers issuers' compliance costs as issuers can determine whether the phrase is applicable based upon their specific facts and circumstances. But we also recognize that our decision not to define this phrase could increase uncertainty for issuers on how the phrase should be implemented and may therefore result in additional costs to some issuers. For example, the uncertainty associated with leaving the phrase undefined could lead some issuers to interpret the definitions in a manner that is more expansive than if these terms were defined, thus incurring a higher compliance cost than is necessary. In this regard, some issuers may decide to use more internal or external resources than if this phrase was defined to make sure they are compliant with the rule, which would also increase compliance costs. The lack of a clear definition could also result in a diminishment of the benefit of the rule if some issuers are less rigorous in determining and reporting on their products that have conflict minerals, which would reduce the informativeness of their disclosure.

We have attempted to mitigate the potential cost of leaving the phrase undefined by the guidance we provide in the release. Our guidance provides issuers with contributing factors that they should use in their determination of "necessary to the functionality or production," which will reduce the possibility that some issuers may interpret the phrase in either an over or underinclusive manner. Also, we noted concerns that there is ambiguity in the application of the provision to conflict minerals that do not end up in the product, and, as noted above, commentators were mixed in their views regarding how the rule should treat catalysts and other conflict minerals necessary to the production of a product that do not appear in the product. After considering the comments, we agree that it would be very difficult for any manufacturer of products that do not themselves contain conflict minerals to know every conflict mineral used in the production process. Therefore, we used our discretion to decide that, for a conflict mineral to be considered "necessary to the production" of the product, the conflict mineral must be contained in the product – and be necessary to the product's production. Therefore, although this requirement may decrease the number of issuers that are covered under the final rule, we believe this is a reasonable approach that reduces costs to issuers by eliminating an especially challenging aspect from the proposal.

**13. Categories of Issuers**

We do not read the statute as making any distinction among issuers based on the issuer's size or domesticity. As discussed above, although not specifically in the context of smaller reporting companies or foreign private issuers, some commentators suggested that we exempt certain classes of companies from full and immediate compliance with the disclosures required by the Conflict Minerals Statutory Provision.[814] We are concerned that any broad categories of exemptions would undermine the statutory objectives discussed above. For the provision to have the effect we understand Congress intended, we are not exempting any class of issuer from its application. We recognize that this imposes a cost burden on those issuers who are not exempted, but conclude that this burden is required by the statute.

Additionally, as one commentators noted, it is unclear whether exempting smaller

[814] See, e.g., letters from Davis Polk, NCTA, Verizon, and WilmerHale.

reporting companies would significantly reduce their burdens because smaller reporting companies could still be required to track and provide their conflict minerals information for larger issuers.[815] Moreover, as other commentators noted, to the extent there are benefits to smaller companies from an exemption, such an exemption could increase the burden on larger companies that rely on smaller reporting company suppliers to provide conflict minerals information needed by the larger reporting companies.[816] Further, the temporary availability of the "DRC conflict undeterminable" category is likely to reduce the compliance burden for all companies, including smaller reporting companies. In this regard, not including private companies and individuals in the final rule may not unduly burden reporting issuers because the commercial pressure on private companies from issuers that need this information for their reports and from the public in general demanding that issuers make this information available could be sufficient for the private companies to provide voluntarily their conflict minerals information as standard practice.[817] Further, the extension of the availability of the "DRC conflict undeterminable" category for an additional two years is likely to reduce the compliance burden even more for some smaller reporting companies.

Similarly, exempting foreign private issuers from the final rule could increase domestic issuers' burdens by making it very difficult for them to compel their foreign private issuer suppliers to provide conflict minerals information. In addition, exempting foreign private issuers from the final rule could result in a competitive disadvantage for

815 See letters from IPC I.

816 See, e.g., letters from IPC I and TriQuint I.

817 See letter from Howland and TIC.

domestic issuers because foreign private issuers would not be subject to the final rule.[818] Overall, we are not exempting foreign private issuers because we believe that doing so would not give effect to Congressional intent.

### 14. Not Including Mining Issuers as Manufacturing Issuers

The Conflict Minerals Statutory Provision does not state whether issuers that mine conflict minerals should be considered to be manufacturing those minerals and be included under the provision. We do not consider an issuer that mines or contracts to mine conflict minerals to be manufacturing or contracting to manufacture those minerals unless the issuer also engages in manufacturing, whether directly or through contract, in addition to mining. In this regard, we do not believe that mining is "manufacturing" based on a plain reading of the provision. Excluding such mining issuers from the universe of covered companies could create a competitive advantage for those companies over covered companies to the extent that they are competitors, but this advantage should be diminished for mining companies that are suppliers of conflict minerals to covered companies because the covered companies would require the conflict minerals information from the mining company. Also, excluding such mining issuers from the final rule could increase costs to other issuers along the supply chain because, without being covered, such mining issuers may not have the incentive to share origin and chain of custody information about the conflict minerals they mined. However, not including such mining issuers may decrease certain costs for mining issuers, since such issuers will not have to comply with the Conflict Minerals Statutory Provision with respect to conflict

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[818] See letter from CEI II, Rep. Amodei, Rep. Ellmers, Rep. Murphy, and TriQuint I.

minerals mined by such issuers (unless necessary to the production or functionality of a product manufactured, or contracted to be manufactured, by such issuer). However, we expect that such mining issuers will incur costs to provide information on the source and custody of conflict minerals mined by such issuers to their customers, and other participants in their supply chain, who are subject to the Conflict Minerals Statutory Provision.

**D. Quantified Assessment of Overall Economic Effects**

As noted above, Congress intended for the rule issued pursuant to Section 1502 to decrease the conflict and violence in the DRC, particularly sexual and gender based violence.[819] A related goal of the statute is the promotion of peace and security in the Congo.[820] These are compelling social benefits, which we are unable to readily quantify with any precision, both because we do not have the data to quantify the benefits and because we are not able to assess how effective Section 1502 will be in achieving those benefits.[821] We also note that these objectives of Section 1502 appear to be directed at achieving overall social benefits and are not necessarily intended to generate measurable, direct economic benefits to investors or issuers specifically. Additionally, the social

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[819] Section 1502(a) of the Act ("It is the sense of the Congress that the exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation therein, warranting the provisions of section 13(p) of the Securities Exchange Act of 1934, as added by subsection (b).").

[820] See Section 1502(d)(2)(A) of the Act (directing the GAO to assess the effectiveness of Exchange Act Section 13(p) in promoting peace and security in the Covered Countries).

[821] Some commentators argued, however, that the Conflict Minerals Statutory Provision has already pressured DRC authorities to begin to demilitarize some mining areas and to increase mining oversight. See, e.g., letters from International Corporate Accountability Roundtable (Jul. 29, 2011) ("ICAR I"), Sen. Boxer et al. I, Sen. Leahy et al., and United Nations Group of Experts on the Democratic Republic of Congo (Oct. 21, 2011) ("UN Group of Experts").

benefits are quite different from the economic or investor protection benefits that our rules ordinarily strive to achieve. We therefore have not attempted to quantify the benefits of the final rule.

Based on comments and our analysis, we do expect that the statute will result in significant economic effects. We have noted the views of commentators on direct compliance costs, and we acknowledge that these costs are substantial. In addition, issuers with a reporting obligation under the Conflict Minerals Statutory Provision could be put at a competitive disadvantage with respect to private companies that do not have such an obligation.[822] We note, however, that non-reporting companies are part of the supply chain of reporting issuers and will bear many of the compliance costs of determining whether their minerals are conflict-free.[823] We also expect that the implementation of the statute may provide significant advantage to foreign companies that are not reporting in the United States – and thus need not comply – but do compete directly with reporting issuers in the United States. In requiring the Commission to promulgate this rule, however, Congress determined that its costs were necessary and appropriate in furthering the goals of helping end the conflict in the DRC and promoting peace and security in the DRC. To the extent the final rule implementing the statute imposes a burden on competition in the industries of affected issuers, therefore, we believe the burden is necessary and appropriate in furtherance of the purposes of Section

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[822] In our Economic Analysis, we use the term "competition" to mean competition in the industries of the affected issuers, not competition in all of the markets that the Commission is charged with regulating, which are the United States securities markets. We do not expect any effects of the rule on the competition in the United States securities markets.

[823] See, e.g., letters from Japanese Trade Associations and NAM I.

13(p). Also, if foreign jurisdictions implement similar laws or regulations similar to Section 1502 or the final rule,[824] any advantages available to foreign companies listed in such jurisdictions but not listed in the United States may be diminished.

As we have observed, unlike in most of the securities laws, Congress intended the Conflicts Mineral Provision to serve a humanitarian purpose, which is to prevent armed groups from benefiting from the trade of conflict minerals. There may also be a benefit to investors given the view expressed by some commentators that the provision also protects investors by requiring disclosure of information that may be material to their understanding of the risks of investing in an issuer or its supply chain. To the extent that the required disclosure will help investors in pricing the securities of the issuers subject to the Conflict Minerals Statutory Provision, the rule could improve informational efficiency. Because, however, the cost of compliance for this provision will be borne by the shareholders of the company, which could potentially divert capital away from other productive opportunities, the rule may result in a loss of allocative efficiency. The reduction in allocative efficiency could be offset, somewhat, by increased demand for the firm's products and/or shares by socially conscious consumers and investors. We do not expect that the rule would negatively impact prospects of the affected industries to an extent that would result in withdrawal of capital from these industries. Thus, we do not expect the rule to have a significant impact on capital formation.

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[824] See cf. letters from Member of the European Parliament (Nov. 17, 2011) ("European Parliament") (stating that in "2010 the European Parliament adopted a resolution welcoming the adoption of the new US 'Conflict Minerals' Law and asked the Commission and the Council to examine a legislative initiative along these lines") and NEI (stating that "[s]imilar action can be expected in other countries in response to the SEC's leadership, and as global awareness of the conflict minerals issue increases," that "conflict minerals legislation [in Canada] has already been tabled," and "the Canadian Securities Administrators (CSA) pay[s] close attention to SEC rule-making developments").

There may, however, be several indirect economic effects that could be significant. The high cost of compliance provides an incentive for issuers to choose only suppliers that obtain their minerals exclusively from outside the Covered Countries, thereby avoiding the need to prepare a Conflict Minerals Report. To the extent that Covered Countries are the lowest cost suppliers of the minerals affected by the statute, issuers preferring to find substitutes or other suppliers of non-DRC minerals would have to increase the costs of their products to recoup the higher costs. Reducing the viable supply of such minerals may have the indirect effect of increasing the cost of acquiring these minerals.

As mentioned above, the overall specific range of costs for compliance with the rule provided by commentators was between $387,650,000 and $16 billion. The wide divergence of the cost estimates among the four separate analyses submitted by a manufacturing industry association,[825] an electronic interconnect industry association,[826] a university group,[827] and an environmental consultancy company[828] illustrates to us the difficulty of ascertaining the estimated costs of implementing the statute and our discretionary choices. We have reviewed the proposal and the comments received and have used the information provided by commentators to inform our Economic Analysis of the final rule. In the remaining part of this section we attempt to quantify, to the extent possible, the compliance costs resulting from the final rule by relying on and critically

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[825] See Section III.B.2.b.i.

[826] See Section III.B.2.b.ii.

[827] See Section III.B.2.b.iii.

[828] See Section III.B.2.b.iv.

evaluating the estimates and the analyses that commentators provided. Rather than using a single analysis, a combination of the analyses can provide a useful framework for understanding various cost components of our implementing the rule. Our approach strives to achieve a balanced and reasonable analysis based on the data and assumptions provided by all commentators, as well as our own analysis and assumptions. When it is deemed prudent, we have chosen to make conservative assumptions that may, in some cases, lead to an overestimation of the costs. Overall, after performing our analysis we conclude that the costs of the statute will be substantial. Thus, we have revised our own prior estimate of the cost of complying with the rule. Based on our analysis of the data, we provide a range of the costs of both initial compliance and the annual cost of ongoing compliance. In our view, because of the potential variations in the manner in which issuers will undertake compliance, providing such a range is more appropriate than providing a precise cost estimate. Our revised estimate is that the initial cost of compliance is between approximately $3 billion to $4 billion, while the annual cost of ongoing compliance will be between $207 million and $609 million.

We start our analysis of the cost of compliance by incorporating all of the comments that provide quantified data on the aggregate potential costs of the proposed rule. So, while our overarching consideration of the costs of the rule we are adopting today takes into account the information provided by a broad range of commentators, the most useful frameworks for considering costs were provided by the manufacturing industry association and university group commentators. Other comments, while also providing certain valuable insights into how our rules would be implemented, were either not as transparent in their analytical frameworks or not easily generalizable in terms of aggregating the costs across multiple industries.[829]

We also found it significant that the two analyses by the manufacturing industry association and university group commentators take into account the categories of costs most often identified as significant by commentators and that we agree are likely to be deemed as such. Moreover, we did not find the assumptions underlying their frameworks to be qualitatively different from the discussions of costs provided by other commentators.

At the same time, in our view, even these two studies did not provide sufficiently documented evidence to support all of their assumptions and assertions and consequently, commentators differed on the quantification of these costs. We have therefore taken into account the views expressed in other comment letters, and made modifications to the analyses provided by the manufacturing industry association and university group commentators accordingly. What follows is a modified analysis of the manufacturing industry association and university group commentators' estimates that we believe better synthesizes the information provided to us in the comment process.

First, in both of these estimates, an important consideration is the cost of upgrading or implementing changes to IT systems. Based on the letters submitted as well as estimates from other commentators, we believe the manufacturing industry association and university group commentators may have been over-inclusive in their estimates. For example, the environmental consultancy company commentator estimates a much smaller

[829] As shown below, while we draw on the quantified analyses supplied by the electronic interconnect industry association and the environmental consultancy company commentators, these letters did not provide as broad a range of quantified cost estimates as those provided by the manufacturing industry association and university group commentators.

number of $25,000 for the IT system and $10,000 for IT support.[830] The commentator then states that, "a cost of $6B is 10 times the total annual sales for all restricted materials software (of which conflict minerals is a small part) and does not seem realistic . . . [p]articularly since conflict minerals software for small companies can be downloaded for free." The environmental consultancy company commentator further states that "[t]he systems quoted by [the manufacturing industry association and university group commentators] are the most expensive systems on the market," and that "[m]ost companies we interviewed said they would not need to invest in new software solely for conflict minerals . . . ."[831]

While we are persuaded by the argument that an average issuer should not expect to spend $1,000,000 to invest in a new IT system, we do not accept the environmental consultancy company commentator's own estimate of $35,000 because it does not provide a factual basis for the assertion. In modifying the estimates of the manufacturing industry association and university group commentators, we do not intend to replace the manufacturing industry association and university group commentators' cost estimates with the smaller estimate provided; rather, for purposes of our cost estimate, the appropriate estimate lies somewhere in between those two estimates.

Based on the university group commentator's analysis, we assumed $205,000 for small company computer costs rather than $1,000,000. Further, we assumed that the computer costs for large issuers would be twice those for smaller issuers, or $410,000,

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[830] See letter from Claigan III. See also letter from Assent (critiquing the cost estimates of both the manufacturing industry association commentator and the university group commentator).

[831] Letter from Claigan III.

and not four times those for a smaller issuer as assumed by the university group commentator.[832] In order to make the IT cost analysis consistent between the university group and the manufacturing group's revised analysis, we averaged the total IT cost per company in the university analysis and divided it by the total number of issuers for an average IT cost for all companies (irrespective of size) of approximately $250,000 and apply it to the manufacturing group's analysis.[833] This respectively changes the manufacturing industry association and university group commentators' estimates of the total IT cost from $5.9 billion and $2.6 billion, respectively, to approximately $1.5 billion.

Second, another important cost assumption is that the manufacturing industry association commentator assumes that each issuer has an average of 2000 first-tier suppliers. They arrive at this number based on their "consultations with a number of large manufacturers, and based on research by" others. This estimate of the average number of first-tier suppliers is, however, not supported by other estimates, and is in fact difficult to reconcile with figures reported by other commentators. For example, the average number of suppliers per company in the electronic interconnect industry association commentator study is only 163.[834] The environmental consultancy company commentator also believes the supply chain would be much simpler than the manufacturing industry association commentator predicts, based on the EICC/GeSI

[832] The environmental consultancy company commentator estimates that the IT costs for a company with $1 billion in revenue to be $35,000. Our estimate of IT costs attempts to incorporate these two widely varying viewpoints. See letter from Claigan III.

[833] Approximately $1.5 billion/5,994 issuers.

[834] See letter from IPC I.

process. The manufacturing industry association commentator maintains, however, that many of its members have well over 2,000 suppliers. We do think a prudent reduction in the manufacturing industry association commentator's estimate is warranted, but here again, we do not know that 163 is any more representative of an average company's experience. Thus, we use the university group commentator's estimate of 1,060 suppliers while employing the manufacturing industry association commentator's analysis. Revising the manufacturing industry association commentator's number of suppliers in the supply chain lowers their estimate of compliance costs from $1.2 billion to $635 million.

In addition, we are not convinced that the estimate of cost to suppliers is appropriately generated by a top-down approach (number of supplier relationships). Indeed, we think a top-down approach may not reflect how our rule may be implemented because it is not clear how the market may react in placing the various burdens of traces on the countless entities in the supply chains. In this top-down approach (which is the approach used by many commentators) each firm using these minerals will need to track backwards through each supplier. If many firms share the same supplier, the underlying assumption is there are few economies of scale in determining whether the minerals are conflict-free. Under this approach, each firm pays an independent cost of finding out from each of their suppliers where the minerals originate.[835]

[835] The university group commentator states that there are "overlap" or "mutuality" cost efficiencies that will emerge on the supplier side, as the same supplier may have supply contracts with more than one issuer thus allowing them to use any management systems changes to meet the needs of multiple issuers. This commentator estimates that supplier efforts will be reduced by 60% because of this supplier-issuer overlap and modifies the number of suppliers accordingly. See letter from Tulane.

We believe, however, that due diligence on the part of suppliers likely will be a bottom-up approach in which materials are tagged at the mine and certified at the smelter and then are introduced into the supply chain. Given this bottom-up approach, each supplier will then track whether the mineral is conflict-free and to whom it will be sold. While the system for tracking the sales of these minerals may increase in magnitude with the number of companies the supplier supplies, we believe the better approach to estimating costs of the supply chain would be to estimate the total number of affected suppliers (bottom-up) rather than the total number of supplier relations (top-down).

A bottom-up approach places more emphasis on the number of suppliers and assumes that there are economies of scale in the cost because suppliers need only determine the source of their minerals once and then spread the cost of determining the source across many issuing firms. For example, if issuers have many suppliers to choose from, they may find it easier to deal with – and hence more valuable to employ – only those suppliers who can fully attest that they are conflict-free. Therefore, if all first-tier suppliers bear the burden of certifying and providing conflict reports, then the relative burden on the issuers will be very small. All of this will, however, depend in turn on the comparative bargaining power between the issuers and the suppliers at every level. Ultimately, none of the studies have provided compelling explanations for the precise dynamics that will govern the issuer-supplier or first-tier supplier-second-tier supplier relationships. On the whole, we think it would be much more reasonable to believe that suppliers at all levels will expend some effort individually in providing information to some of their customers regarding the source of their minerals, but each supplier's effort in turn will most likely reduce the cost of its customers to comply with our rules.

Few commentators provided an estimate of the total number of suppliers affected. In the university group commentator's estimate, even after adjusting for potential overlap, the total number of suppliers to be affected totals over 860,000, which is based on the total supply chain. Using the total supply chain to estimate the affected suppliers will create redundancies because a supplier may be in more than one supply chain and therefore, be counted multiple times. Thus, we believe the total number of suppliers affected in the university group commentator's analysis is likely to be too high. The manufacturing industry association commentator, on the other hand, estimated the total number of small and medium-sized manufacturing businesses to be affected at 278,000 and states that many of these small businesses are likely to be suppliers. The 2009 Statistics of U.S. Businesses from the U.S. Census estimates the total number of manufacturing businesses at 266,175, and the number of small manufacturing businesses (those with fewer than 500 employees) at 262,524.[836] Both of these numbers are similar to the number provided by the manufacturing industry association commentator. We

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[836] See U.S. CENSUS BUREAU, STATISTICS OF U.S. BUSINESS (2009), available at http://www.census.gov/econ/susb/. We recognize that the US Census Bureau uses the NAICS definitions, including the definition of "manufacturing." As discussed above, we did not adopt that definition for the final rule because it appears to exclude any issuer that manufactures a product by assembling that product out of materials, substances, or components that are not in raw material form, which would exclude large categories of issuers that manufacture products through assembly. However, we believe it is not inappropriate to use the Census Bureau's data regarding the total number of manufacturing businesses and the number of small manufacturing businesses in determining whether to use the number of suppliers provided by the university group commentator or the number provided by the manufacturing industry association commentator. Because we only have two real choices in the number of suppliers to use for our calculations, we need some way to determine which figure is a more viable estimate. Despite the fact that the Census Bureau uses the NAICS definition of "manufacturing," which may exclude certain manufacturers, it would need to exclude almost 600,000 manufacturers for the university group commentator's figure to be more accurate than the manufacturing industry association commentator's figure. This appears to be too high. Therefore, because the manufacturing industry association commentator's figure is so much closer to the Census Bureau's figures, we decided it would not be inappropriate to use the manufacturing industry association commentator's figure even though our reasoning was based on the NAICS definition of "manufacturing."

therefore have revised the university group commentator's analysis on the number of affected suppliers to be consistent with the manufacturing industry association commentator at 278,000 to reflect this judgment. In addition, consistent with the university group commentator framework, we assumed that the same percentage of suppliers as issuers would be considered large (28%) and small (72%). Thus, in our revised university group commentator's analysis, the total number of large suppliers is 77,840 while the total number of small suppliers is 200,160. This changes the total compliance cost for suppliers from $5.1 billion in the university group commentator's analysis to $1.2 billion in our revised analysis.

The overall impact of these changes to the analysis, a reduction in IT costs (to both the manufacturing industry association and university group commentators), a modification in the number of suppliers in the supply chain (to the manufacturing industry association commentator) and a decrease in the number of suppliers affected (to the university group commentator) changes the total estimated cost of compliance substantially. The manufacturing industry association commentator's estimate declines from $9.3 billion to $4.1 billion while the university group commentator's estimate drops from $7.94 billion to $3.0 billion.

The combination of these modifications in the two analyses leads us to estimate that initial compliance costs could be between $3.0 and $4.0 billion for all companies to comply with the statutory requirements. Below are the two revised analysis in tabular form with the revised estimates highlighted in bold:

| Revised | | |
|---|---|---|
| **Manufacturing Industry Association Commentator** | | Calculation |

| | | |
|---|---|---|
| **Estimate** | | |
| Issuers affected | 5,994 | |
| Average number of 1st tier suppliers | **1,060** | 2000*.53 |
| | | |
| **Issuer Due Diligence Reform**[837] | | |
| Number of compliance hours per supplier | 2 | |
| Cost per hour | $50 | |
| **Total compliance cost** | *$635,364,000* | 5,994*1,060*2*$50 |
| | | |
| **IT Systems Modification**[838] | | |
| Cost per issuer | **$250,000** | |
| **Total cost** | *$1,498,500,000* | 5,994*$250,000 |
| | | |
| **Conflict Minerals Report Audits** | | |
| Issuers to do audit[839] | 4,500 | 5,994*75% |
| Audit cost for issuers | $100,000 | |
| **Total cost** | *$450,000,000* | 4,500*100,000 |
| | | |
| **Issuer Verification of Supplier Information** | | |
| Number of hours | 0.5 | |
| Cost per hour | $50 | |
| **Total cost** | *$158,841,000* | 5,994*1,060*0.5*$50 |
| | | |
| **Smaller Supplier Due Diligence**[840] | | |
| Suppliers affected (only 20% to conduct) | 55,600 | 278,000*.2 |
| Due diligence cost | $25,000 | |
| **Total cost** | *$1,390,000,000* | 278,000*.2*$25,000 |
| | | |
| **TOTAL** | $4,132,705,000 | |

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837 The manufacturing industry association commentator refers to this as "changes to their corporate compliance policies." See letter from NAM I.

838 The manufacturing industry association commentator refers to this as IT system development or revision. See id.

839 We are using the rounded estimate (4,500) that was used by the university group and manufacturing industry association commentators in their calculations even though a more exact number of issuers would be 4,496 (.75 x 5,994 = 4,495.5). See infra note 869.

840 The manufacturing industry association commentator refers to this as the cost of providing "proper information regarding the source of minerals." Id.

| Revised | | |
|---|---|---|
| **University Group Commentator Estimate** | | Calculation |
| Issuers affected | 5,994 | |
| Large issuer (28% of issuers) | 1,678 | 5,994*0.28 |
| Small issuer (72% of issuers) | 4,316 | 5,994*0.72 |
| Number of 1st tier suppliers (53% of NAM) | 1,060 | 2,000*0.53 |
| | | |
| **Issuer Due Diligence Reform** | | |
| Number of compliance hours for large issuer | 100 | |
| Number of compliance hours for small issuer | 40 | |
| Internal cost per hour | $50 | |
| Internal costs for large issuer (90% of total work load) | *$7,551,000* | 1,678*0.9*100*$50 |
| Internal costs for small issuer (75% of total work load) | *$6,474,000* | 4,316*0.75*40*$50 |
| Consulting cost per hour | $200 | |
| Consulting costs for large issuer (10% of total work load) | *$3,356,000* | 1,678*0.1*100*$200 |
| Consulting costs for small issuer (25% of total work load) | *$8,632,000* | 4,316*0.25*40*$200 |
| **Total cost** | *$26,013,000* | |
| | | |
| **IT Systems Modification** | | |
| Cost per large issuer | $410,000 | |
| Cost per small issuer | $205,000 | |
| Total large issuer cost | *$687,980,000* | 1,678*$410,000 |
| Total small issuer cost | *$884,780,000* | 4,316*$205,000 |
| **Total costs** | *$1,572,760,000* | |
| | | |
| **Conflict Minerals Report Audits** | | |
| Issuers affected[841] | 4,500 | |
| Number of large issuers | 1,260 | 4,500*0.72 |
| Number of small issuers | 3,240 | 4,500*0.28 |
| Large issuer cost | $100,000 | |
| Small issuer cost | $25,000 | |

[841] We are using the rounded estimate (4,500) that was used by the university group and manufacturing industry association commentators in their calculations even though a more exact number of issuers would be 4,496 (.75 x 5,994 = 4,495.5). See infra note 869.

| | | |
|---|---|---|
| Total costs for large issuers | *$126,000,000* | 1,260*$100,000 |
| Total costs for small issuers | *$81,000,000* | 3,240*$25,000 |
| **Total costs** | *$207,000,000* | |
| | | |
| **Supplier Due Diligence Reform** | | |
| Total large suppliers | **77,840** | 278,000*.28 |
| Total small suppliers | **200,160** | 278,000*.72 |
| Number of compliance hours for large supplier | 100 | |
| Number of compliance hours for small supplier | 40 | |
| Internal cost per hour | $50 | |
| Internal costs for large supplier (90% of total work load) | *$350,280,000* | 77,840*100*0.9*$50 |
| Internal costs for small supplier (75% of total work load) | *$300,240,000* | 200,160*40*0.75*$50 |
| Consulting cost per hour | $200 | |
| Consulting costs for large supplier (10% of total work load) | *$155,680,000* | 77,840*100*0.1*$200 |
| Consulting costs for small supplier (25% of total work load) | *$400,320,000* | 200,160*40*0.25*$200 |
| **Total cost** | *$1,206,520,000* | |
| | | |
| **TOTAL** | $3,012,293,000 | |

The manufacturing industry association and the university group commentators also provided estimates of ongoing compliance costs. As discussed above, we consider the framework provided by these commentators to be the most useful for estimating costs. The only other commentator to provide an estimate of ongoing costs was the electronic interconnect industry association commentator, but its analysis only included companies in that industry. The analyses provided by the manufacturing industry association and university group commentators yield costs estimates across multiple industries. The manufacturing industry association group commentator estimated an ongoing audit cost of $450 million and an ongoing cost estimate of approximately $300 million for issuer verification of supplier information.[842] In our table above, however, we revised the estimate for issuer verification of supplier information to approximately $159 million.[843] We did not modify the approximately $450 million cost estimate of the audit, which was based on its estimate that the cost of such an audit for these issuers would be $100,000 per issuer, and not the $25,000 we estimated it to be in the Proposing Release. The total estimate of ongoing compliance costs based on our revisions to the manufacturing industry association commentator's analysis is therefore approximately $609 million.[844] We believe that the university group commentator's only significant recurring costs are the approximately $207 million audit costs.[845] As with the manufacturing industry association commentator, we did not modify the approximately $207 million cost estimate of the audit. Therefore, we believe that the ongoing compliance cost estimate is likely to be in the range of $207 million to $609 million.[846]

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842 See letter from NAM I.

843 5,994*1,060*0.5*$50 = $158,841,000

844 $450,000,000 + $158,841,000 = $608,841,000

845 The university group commentator noted that "there would be some internal operations costs associated with performing ongoing due diligence and maintaining the necessary [information technology] systems on a company-to-company basis over the years," but that the "recurring costs of operating same is very low compared with the initial implementation." See letter from Tulane.

846 The manufacturing industry association commentator also quotes compliance costs by Technology Forecasters, Inc on the RoHS directive. Using the RoHS directive, they estimate total compliance costs of $32 billion and $3 billion annually for maintenance. See letter from NAM I. One potential method to estimate ongoing costs is to apply the ratio of initial compliance costs to ongoing compliance costs (9.375%) in the submitted RoHS analysis ($3 billion/$32 billion or 9.375%) and apply it to our revised estimates of the analyses of the manufacturing industry association and university group commentators. This results in total ongoing estimated compliance costs of $400 million ($4.1 billion * 9.375%) and $281 million ($3.0 billion * 9.375%), respectively. However, because the manufacturing industry association commentator does not specify the composition of these maintenance costs (e.g., it is not stated whether this includes audit costs), nor does it provide the underlying RoHS study for verification, we are unable to confirm the accuracy of this ratio.

## IV. PAPERWORK REDUCTION ACT

### A. Background

Certain provisions of the final rule contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 (the "PRA").[847] We published a notice requesting comment on the collection of information requirements in the Proposing Release for the proposed rules and amendments. The proposed rules and amendments would have amended one regulation and three forms. In response to comments received from the public, the Commission has decided to adopt a new disclosure form, rather than amend existing rules and forms. We have submitted the new collection of information requirements to the Office of Management and Budget (the "OMB") for review in accordance with the PRA.[848]

The title for the collection of information is:

"Form SD" (a new collection of information).

The form is adopted under the Exchange Act and sets forth the disclosure requirements for reports filed by certain issuers regarding their use of conflict minerals from the Covered Countries. The hours and costs associated with preparing and submitting the form constitute the reporting and cost burdens imposed by the collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. Compliance with the rule is mandatory. Responses to the information collection will not

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[847] 44 U.S.C. 3501 et seq.

[848] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

be kept confidential and there is no mandatory retention period for the information disclosed.

### B. Summary of the Comment Letters

In the Proposing Release, we requested comment on the PRA analysis. We received only one comment letter that addressed the PRA explicitly,[849] but we received a number of other comment letters and submissions that discussed the costs and burdens to issuers generally that would have an effect on the PRA analysis.[850] A detailed discussion of these comments is included in the section III above regarding the Economic Analysis of the statute. In the Proposing Release, we estimated that approximately 5,994 of the approximately 14,600 annual reports are filed by issuers that would be affected by the proposed rules and form amendments.

The letter discussing the PRA specifically was from the manufacturing industry association commentator.[851] The commentator concluded that, of the 5,994 issuers that the Proposing Release stated could be affected by the final rule, the average issuer would have between 2,000 to 10,000 first-tier suppliers. The commentator agreed, therefore, with our statement in the Proposing Release that the paperwork costs could be significant because the disclosure requirement in the proposed rules "drastically increases the amount of paperwork issuers will have to collect and provide to the SEC to make the

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[849] See letter from NAM I.

[850] See, e.g., letters from Assent, Barrick Gold, CEI I, CEI II, Chamber I, Chamber III, Claigan I, Claigan II, Claigan III; CTIA, Ford, Howland, IPC I, ITRI I, ITRI II, ITRI III, Japanese Trade Associations, NAM I, NRF I, PCP, Rep. Lee, Roundtable, Society of Corporate Secretaries and Governance Professionals (Jun. 21, 2011) ("Corporate Secretaries II"), TriQuint I, Tulane, United States Chamber of Commerce (Jul. 18, 2011) ("Chamber II"), and WGC I.

[851] See letter from NAM I.

required disclosures."[852] The amount calculated by the commentator was $9.4 billion, which included approximately "$8 billion for issuers and $1.4 billion from smaller companies that are not issuers."[853]

Our PRA analysis pertains solely to the paperwork burdens of issuers that file reports with us, although we discuss the burdens and costs of the final rule to both reporting issuers and non-reporting companies in our Economic Analysis section above. Therefore, for the purpose of the PRA analysis, we do not take into account the commentator's $1.4 billion figure because it relates solely to non-reporting companies. As a result, the commentator's paperwork burden estimate appears to be approximately $8 billion, which is much higher than our estimate of $46,475,000 in the Proposing Release. Also, as we note above, other commentators provided costs estimates. These commentators did not specifically discuss the costs of the statute or the rule as they relate to the PRA. However, as discussed in greater detail below, we have attempted to extrapolate the paperwork costs from the overall cost estimates of these commentators.[854]

### C. Revisions to PRA Reporting and Cost Burden Estimates

For purposes of the PRA, in the Proposing Release, we estimated that the total

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852 Id.

853 See id. In response to our estimate in the Proposing Release, of 793 reporting companies that would qualify as "small entities" for purposes of the Initial Regulatory Flexibility Act and that have conflict minerals necessary to the functionality or production of products they manufacture or contract to manufacture, the manufacturing industry association commentator noted that "a large portion of America's 278 thousand small and medium-sized manufacturers could be affected by the requirement to provide information on the origin of the minerals in the parts and components they supply to companies subject to the SEC." Id. The commentator estimated, however, that "only one in five smaller companies would be in one or more issuer's supply chains," and these smaller companies' only costs regarding the proposed rules would be a $25,000 audit cost. Id. Therefore, the proposed rules would cost smaller companies that are not required to report with us under Exchange Act Sections 13(a) or 15(d) approximately $1.4 billion. Id.

854 See letters from Claigan I, Claigan II, Claigan III, Claigan IV, IPC I, and Tulane.

annual increase in the paperwork burden for all companies to prepare the disclosure that would be required under the proposed rules would be approximately 153,864 hours of company personnel time and a cost of approximately $71,243,000 for the services of outside professionals. These figures reflected our estimated costs for issuers to satisfy the due diligence and audit requirements of the proposed rules, which we estimated would be $46,475,000. As discussed in more detail below, we are revising our PRA burden and cost estimates in light of the comments we received.

For purposes of the PRA for the final rule, we estimate the total annual increase in the paperwork burden for all affected companies to comply with the collection of information requirements in our final rule is approximately 2,225,273 hours of company personnel time and approximately $1,178,378,167 for the services of outside professionals.[855] These estimates include the time and cost of collecting the information, preparing and reviewing disclosure, and submitting documents. In this regard, we include due diligence, which includes updating information technology systems and obtaining an independent private sector audit, as part of collecting information. We estimate that the total cost for issuers to satisfy their due diligence is $1,030,026,667. We added this estimate to our estimate of the cost to issuers to hire outside professionals to prepare and review disclosure, submit documents, and retain records, which is $148,351,500.[856]

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[855] $1,030,026,667 + $148,351,500 = $1,178,378,167.

[856] We note that commentators rounded many of the calculations they made and used. However, for clarity in the body of the release, we refer to many rounded figures, but we have included the more exact figures and our calculations in the footnotes. Regardless, it does not appear that the rounded numbers vary significantly from the more exact calculations to make them meaningfully different.

Consistent with our methodology in the Proposing Release, in deriving our estimates for the final rule, we recognize that the burdens will likely vary among individual companies based on a number of factors, including the size and complexity of their operations, the number of products they manufacture or contract to manufacture, and the number of those products that contain conflict minerals. We believe that some issuers will experience costs in excess of this average in the first year of compliance with the final rule and some issuers may experience less than these average costs. We base our revised estimates of the effect that the final rule will have on the collection of information as a result of the required reasonable country of origin inquiry, due diligence process, and independent private sector audit of the Conflict Minerals Report primarily on information that we have obtained from comment letters.

In the Proposing Release, we noted that the DRC accounts for approximately 15% to 20% of the world's tantalum, and accounts for a considerably smaller percentage of the other three conflict minerals.[857] Therefore, for the purposes of the PRA, we assumed in the Proposing Release that only 20% of the 5,994 affected issuers would have to provide an audited Conflict Minerals Report, which would have been 1,199 issuers. Both the manufacturing industry association commentator and the university group commentator, however, estimated in their comment letters that 75% of issuers would have to submit a Conflict Minerals Report.[858] Also, the electronic interconnect industry association

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[857] See Proposing Release. See also Jessica Holzer, Retailers Fight to Escape 'Conflict Minerals' Law, THE WALL STREET JOURNAL, Dec. 2, 2010, at B1. The DRC also accounts for approximately 4% of the world's tin, see id., and approximately 0.3% of global gold mine production, see letter from JVC et al. II (citing to GFMS Gold Survey 2010).

[858] See letters from NAM I and Tulane.

commentator indicated that it expected "nearly 100% of affected issuers will need to complete" a Conflict Minerals Report because "the vast majority of [issuers] will be unable to identify the origin of their conflict minerals."[859] However, because of the reasonable country of origin inquiry requirement, the fact that only issuers who know or have reason to believe that their conflict minerals may have originated in the Covered Countries and may not have come from recycled or scrap sources are required to proceed to step three, and the "DRC conflict undeterminable" temporary provision, we believe it is appropriate to estimate that some percentage of issuers will not be required to submit a Conflict Minerals Report, an independent private sector audit, or both. Therefore, for the final rule, we estimate that 75% of all the 5,994 issuers, which is approximately 4,496 issuers,[860] will have to submit a Conflict Minerals Report and provide an independent private sector audit of that report for the first two years after implementation. We note that, under the final rule, issuers that proceed to step three but are unable to determine whether their conflict minerals originated in the Covered Countries, came from recycled or scrap sources, or financed or benefited armed groups in those countries are required to provide a Conflict Minerals Report, but that report does not have to be audited for the first two years following the rule's adoption for all issuers and the first four years for smaller reporting issuers. This change from the proposal could cause the actual costs to issuers for the first two years after implementation, for all issuers and four years after implementation for smaller issuers, to be lower than the commentators' cost estimates.

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[859] See letter from IPC I.

[860] 5,994 issuers x 75% = 4,495.5.

We believe, however, that our assumption that 75% of affected issuers will have to submit a Conflict Minerals Report and provide an independent private sector audit of that report will balance some of the cost estimate discrepancies because 75% was lower than the 100% estimate of the number of affected issuers.[861]

**1. Estimate of Conducting Due Diligence, Including the Audit**

We received a number of comments regarding the estimated costs of the proposed rules, particularly setting up the overall supply chain tracking systems and conducting an audit. The cost estimates provided by the manufacturing industry association commentator and the university group commentator were the most comprehensive because they discussed the costs to all companies, including issuers and private company suppliers.[862] We note that the electronic interconnect industry association commentator provided an extensive discussion of the costs of the proposed rules.[863] Its discussion and cost estimates, however, were limited to the electronic interconnect industry, which is only one segment of affected issuers. Also, although the tin industry association commentator's estimates were useful, they were limited to the costs of its bag-and-tag system, which covers only the costs of due diligence for the portion of the supply chain from the mine to the smelter.[864] For the PRA estimate of the due diligence costs, we relied primarily on the cost estimates from the manufacturing industry association and the

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861 See letters from IPC I (stating that nearly 100% of affected issuers would have to complete a Conflict Minerals Report) and NAM I (stating that it "conservatively" estimated that 75% of affected issuers would have to provide an audited Conflict Minerals Report).

862 See letters from NAM I and Tulane.

863 See letter from IPC I.

864 See letter from ITRI II.

university group commentators and, to a lesser extent, we also relied on the electronic interconnect industry association commentator's estimates.[865]

The manufacturing industry association commentator estimated that the initial costs to affected issuers would be approximately $8 billion.[866] This commentator's only two recurring costs in its $8 billion estimate were the approximately $300 million cost for risk-based programs needed to verify the credibility of suppliers' information, which the commentator indicated would be incurred "on an annual basis,"[867] and the approximately $450 million cost for the annual audit of the Conflict Minerals Report, which together total $750 million.[868]

The university group commentator estimated that the initial costs to affected issuers would be approximately $2.8 billion,[869] and the cost to affected issuers in

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[865] We note that in the Economic Analysis above, we provided a range to estimate the ongoing compliance costs. For purposes of the PRA, however, which calls for a specific estimate of the total annual paperwork burden imposed by the rule, we are using two of the data points within that range based on the more comprehensive comment letters we received and are then averaging the results to yield a final PRA estimate.

[866] We calculate the exact amount, based on the commentator's estimates and assumptions, to be $7,941,250,000. The commentator stated that this cost would include changing legal obligations, changing IT systems, obtaining an independent private sector audit, and implementing risk-based programs. Changing legal obligations would entail 2 hours for each affected issuer's 2,000 suppliers at $50 per hour [2 x $50 x 2,000 x 5,994 = $1,198,800,000.]. Changing IT systems would entail a cost of $1 million per affected issuer [$1 million x 5,994 = $5,994,000,000]. Obtaining an audit would entail a cost of $100,000 for 75% of all affected issuers [$100,000 x 75% x 5,994 = $449,550,000]. Implementing risk-based programs would entail 1,000 hours at a cost of $50 per hour for all affected issuers [1,000 x $50 x 5,994 = $299,700,000].

[867] See letter from NAM I.

[868] The actual cost would be $749,250,000 [$449,550,000 + $299,700,000 = $749,250,000].

[869] The actual estimated cost was $2,795,793,000. This cost estimate included a $2,562,780,000 cost for instituting the necessary IT systems [$1,678,000,000 for large issuers plus $884,780,000 for small issuers], a $26,013,000 cost for strengthening internal management systems in view of performing due diligence, and a $207,000,000 cost for the independent private sector audit. The university group commentator estimated the audit cost to be exactly $207 million by using the manufacturing industry association commentator's estimate that 4,500 of the 5,994 affected issuers (75%) would be required to obtain an audit

subsequent years would consist primarily of the approximately $207 million portion of that amount that would be used for the annual audit of the Conflict Minerals Report.[870]

As discussed above in section III, however, we adjusted the cost estimates provided to us by the manufacturing industry association and the university group commentators. Therefore, our overall estimate regarding the costs of conducting due diligence, including the audit, is based on the modified cost figures. Although the manufacturing industry association commentator estimated that the initial costs to affected issuers would be approximately $8 billion, we modified that figure to be approximately $2.7 billion for affected issuers.[871] In this regard, we modified that commentator's approximately $300 million cost estimate for risk-based programs to be approximately $159 million.[872] We did not, however, modify the commentator's approximately $450 million cost estimate of the independent private sector audit for affected issuers, which was based on its estimate that the cost of such an audit for these

of their Conflict Minerals Report. The 4,500 figure, however, is rounded up from a more exact calculation of 75% of 5,994. The more exact calculation for 75% of 5,994 is 4,496 [5,994 x .75 = 4,459.5], and not 4,500, but both the university group commentator and the manufacturing industry association commentator rounded to 4,500. Using the electronic interconnect industry association commentator's estimates that 72% of all affected issuers are small and medium-sized issuers (under $99 million in annual sales) and 28% are large issuers, the university group estimated that, of the 4,500 affected issuers, 3,240 were small and medium-sized issuers and 1,260 were large issuers. The university group commentator assumed that, based on the manufacturing industry association commentator's estimates, an audit for small and medium-sized issuers would cost $25,000 per audit and an audit for large issuers would cost $100,000 per audit. Using these estimates, the university group determined that the total audit cost amount for affected issuers would be $207 million exactly.

870 See letter from Tulane.

871 Our estimate of the cost is $2,742,705,000. This cost estimate included a $635,364,000 cost for issuer due diligence reform, a $1,498,500,000 cost for IT system modifications, a $450,000,000 cost for the independent private sector audit, and a $158,841,000 cost of risk-based programs needed to verify the credibility of suppliers' information.

872 Our estimate of the cost is $158,841,000.

issuers would be $100,000 per issuer, and not the $25,000 we estimated it to be in the Proposing Release.[873] We note that the electronic interconnect industry association commentator agreed that the costs for an independent private sector audit could be as much as $100,000.[874] The manufacturing industry association commentator noted, however, that $25,000 would cover the audit for a small company with a simple supply chain.[875]

From the approximately $159 million cost estimate for the risk-based programs needed to verify the credibility of suppliers' information, based on our revised calculations of the manufacturing industry association commentator's figures, and that commentator's approximately $450 million cost estimate for the audit, we derive an approximate estimate of $609 million for annual recurring costs.[876] We note that the initial approximately $2.7 billion burden is much greater than the subsequent approximately $609 million annual burden, and we averaged the burdens over the first three years. Over a three-year period, the average annual cost to affected issuers would be approximately $1.32 billion using the manufacturing industry association commentator's figures.[877]

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[873] See letter from NAM I.

[874] See letter from IPC I.

[875] See letter from NAM I. We note that the manufacturing industry association commentator separately indicated that costs of the final rule could be $16 billion or more by extrapolating from the costs of compliance with the RoHS. We did not use this estimate in our analysis because, despite the fact that this commentator claimed that both directives require companies to trace materials used in their products, the commentator did not discuss how RoHS compares to the requirements in the final rule.

[876] $450,000,000 + $158,841,000 = $608,841,000.

[877] ($2,742,705,000 + $608,841,000 + $608,841,000) / 3 = $1,320,129,000.

Additionally, although the university group commentator estimated that the initial costs to affected issuers would be approximately $2.8 billion, we modify that figure to be approximately $1.8 billion.[878] We did not, however, modify the university group commentator's approximately $207 million cost estimate of the independent private sector audit for affected issuers. Therefore, we do not modify the estimate of the cost to affected issuers in subsequent years, which would still be approximately $207 million. Again, the initial approximately $1.8 billion burden is much greater than the subsequent approximately $207 million annual burden, and we also averaged the burdens over the first three years. Over a three-year period, the average annual cost to affected issuers would be approximately $740 million using the university group commentator's figures.[879]

To estimate the overall costs of conducting due diligence, including the audit, we averaged the modified estimates from the manufacturing industry association and the university group commentators discussed above. The average of these two costs is approximately $1.03 billion.[880]

### 2. Estimate of Preparing the Disclosure

The few estimates that we received from commentators regarding the number of hours it would take issuers to prepare and review the proposed disclosure requirements

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[878] The estimated cost was $1,805,773,000. This cost estimate for issuers included the modified $1,572,760,000 cost for instituting the necessary IT systems, the $207,000,000 cost for the independent private sector audit, and the $26,013,000 cost for strengthening internal management systems in view of performing due diligence.

[879] ($1,805,773,000 + $207,000,000 + $207,000,000) / 3 = $739,924,333.

[880] ($1,320,129,000 + $739,924,333) / 2 = $1,030,026,667.

varied widely. One commentator, a semiconductor company, asserted that it would require 1,400 hours initially to implement the proposed rules and 700 hours in subsequent years.[881] The university group commentator suggested that a small issuer would require 40 man-hours to comply with the proposed rules and a large issuer would require 100 man-hours,[882] and it appears that these costs would be recurring.[883] The manufacturing industry association commentator concluded that changing legal obligations to reflect a company's new due diligence would require "at a minimum" two hours of employee time, "and considerably more than two hours is a distinct possibility."[884]

In calculating the number of hours necessary to prepare and review the disclosure required by the final rule, we derived an average based on the estimates provided by the semiconductor company and university group commentators.[885] For the semiconductor

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[881] See letter from TriQuint I.

[882] See letter from Tulane. This commentator stated that an issuer's compliance could be "facilitated" by using third parties. The commentator assumed that large issuers would use third parties for 10% of their compliance needs and small companies would use third parties for 25% of their compliance needs. In our calculations for the number of hours issuers would require in complying with our proposed rules, we did not include third parties because it appears that the use of third parties would not affect the number of hours required for compliance, but would only affect the cost.

[883] Id. This commentator stated that the 100 hours or 40 hours needed to comply with the proposed rules would involve multiple tasks, including: initial reviews of the issuer's policies, procedures, and controls; developing a gap analysis and compliance plan, and modifying that plan as needed; developing draft revised policies, procedures, and controls; conducting initial testing on those revised policies, procedures, and controls; and implementing the revised policies, procedures, and controls, training personnel on them, and communicating them to suppliers. Although many of these are described as "initial" actions, issuers will need to review and modify many of them as well. For example, it is likely that each year issuers may need to review and test their policies, procedures, and controls, modify them as needed, and implement any new further revised policies, procedures, and controls.

[884] See letter from NAM I.

[885] We did not include the two-hour figure from the manufacturing industry association commentator in our estimate because it was so much lower than the other two estimates and did not appear to include all the necessary steps to comply with the proposed rules. Instead, this estimate was based only on the time required to make changes to an issuer's corporate compliance policies and supply chain operating procedures. Also, the university group commentator specifically disagreed with this estimate and the

company commentator estimate, we multiplied its initial 1,400 hour estimate by the 5,994 affected issuers, so the first year's burden for all affected issuers would be approximately 8.4 million hours,[886] and the 700 hour subsequent year estimate also by the 5,994 affected issuers, which resulted in approximately 4.2 million hours for each subsequent year.[887] Averaging the burden hours over the first three years resulted in an average burden hour estimate of approximately 5.6 million hours per year.[888] To determine the estimated number of hours per year per issuer, we divided the 5.6 million hours by 5,994 affected issuers, which resulted in 933 hours per year per affected issuer to comply with the proposed rules.[889]

The university group commentator separated its estimated hours between small and large issuers using the estimated breakdown between the number of affected large and small companies provided by the electronic interconnect industry association in its comment letter.[890] Because we recognized that companies of varying sizes may incur different burdens, we also differentiated between large and small companies in our estimate of burden hours. Therefore, we multiplied the university group commentator's 100 hour estimate for large issuers by the electronic interconnect industry association commentator's estimated 28% for large affected issuers, so the burden for large affected

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manufacturing industry association commentator acknowledged that these actions may take "considerably more than two hours."

[886] 1,400 hours x 5,994 affected issuers = 8,391,600 hours.

[887] 700 hours x 5,994 affected issuers = 4,195,800 hours.

[888] [8,391,600 hours + (4,195,800 hours x 2)] / 3 = 5,594,400 hours average per year.

[889] 5,594,400 hours / 5,994 affected issuers = 933 hours.

[890] See letter from Tulane.

issuers would be 167,832 hours,[891] and multiplied the 40 hour estimate for small issuers by the electronic interconnect industry association commentator's 72% for small affected issuers, which resulted in 172,627 hours for small affected issuers.[892] To determine the estimated number of hours per year per issuer, we added the estimated hours for the small and large companies, which would be 340,459 hours,[893] and divided that number by all the 5,994 affected issuers. Therefore, the average amount of hours per year for each issuer, both large and small, to prepare and review the disclosure required by our rule would be approximately 57 hours.[894] Although not explicit in its comment letter, it appears that the burden hours for the university group commentator's estimates would be incurred annually, so we did not average these hours over the first three years as we did for the semiconductor company commentator's estimate.

Next, we averaged the two burden hour estimates by adding the 933 hour estimate to the 57 hour estimate (and by dividing by two) and determined that each affected issuer, on average, would spend 495 burden hours preparing and reviewing the disclosure.[895] We assumed that 75% of the burden of preparation would have been carried by the company internally and that 25% of the burden of the preparation would have been carried by outside professionals retained by the company at an average cost of $200 per

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[891] 100 hours x 5,994 affected issuers x 28% large affected issuers = 167,832 hours.

[892] 40 hours x 5,994 affected issuers x 72% small affected issuers = 172,627 hours.

[893] 167,832 hours + 172,627 hours = 340,459 hours.

[894] 340,459 hours / 5,994 affected issuers = 56.80 hours.

[895] 933 hours + 57 hours / 2 = 495 hours.

hour.[896] The portion of the burden carried by outside professionals would have been reflected as a cost, while the portion of the burden carried by the company internally would have been reflected in hours. Therefore, the total number of internal preparation hours for affected issuers would be 2,225,273 hours.[897] Similarly, the total cost for external preparation for affected issuers would be $148,351,500.[898]

### 3. Revised PRA Estimate

The following table illustrates the estimated changes in annual compliance burden in the collection of information in hours and costs for the new Exchange Act specialized disclosure report that will result from the final rule. The burden hours figure is the 2,225,273 internal burden hours estimate for preparing the disclosure. We are adding the $148,351,500 estimate of external professional costs for preparing the disclosure to the $1,030,026,667 estimate of conducting due diligence, including the audit, to determine the $1,178,378,167 professional costs in the below table.

| Form | Current Annual Responses | Final Annual Responses | Current Burden Hours (A) | Increase in Burden Hours (B) | Final Burden Hours (C)=(A)+(B) | Current Professional Costs (D) | Increase in Professional Costs (E) | Final Professional Costs (F)=(D)+(E) |
|---|---|---|---|---|---|---|---|---|
| S-D | ...... | 5,994 | .......... | 2,225,273 | 2,225,273 | .......... | $1,178,378,167 | $1,178,378,167 |

[896] The university group commentator estimated that outside professionals would cost $200 per hour because it believed that "a substantial portion" of required consulting work will be done by "lower cost environmental and sustainability consulting firms" instead of large accounting firms that would be more expensive. We frequently use a $400 per hour estimate in our PRA analysis on the assumption that attorneys will be involved in the preparation of the securities law disclosures required by our rules. The disclosure required by the final rule may likely involve work by other types of professionals, so that the $200 per hour estimate may be more appropriate in this circumstance.

[897] 495 hours x 75% internal preparation x 5,994 affected issuers = 2,225,272.50 hours.

[898] 495 hours x 25% external preparation x $200 per hour for outside consultants x 5,994 affected issuers = $148,351,500.

## V. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

This Final Regulatory Flexibility Act Analysis ("FRFA")[899] relates to new rule 13p-1 and new Form SD, which implement Section 13(p) of the Exchange Act. Section 13(p) concerns certain disclosure and reporting obligations of issuers with conflict minerals necessary to the functionality or production of any product manufactured or contracted by those issuers to be manufactured. An Initial Regulatory Flexibility Act Analysis was prepared in accordance with the Regulatory Flexibility Act and included in the Proposing Release.

### A. Reasons for, and Objectives of, the Final Action

The final rule is designed to implement the requirements of Section 1502 of the Act. Specifically, we are adopting amendments to our rules to implement the Conflict Minerals Statutory Provision. The final rule requires any reporting issuer for which conflict minerals are necessary to the functionality or production of a product manufactured or contracted to be manufactured by that issuer to disclose annually in a separate specialized disclosure report on a new form the results of its reasonable country of origin inquiry into whether its conflict minerals originated in the Covered Countries or came from recycled or scrap sources. Under the final rule, following its reasonable country of origin inquiry, if (a) the issuer knows that its conflict minerals did not originate in the Covered Countries or knows that they came from recycled or scrap sources, or (b) the issuer has no reason to believe its conflict minerals may have originated in the Covered Countries, or (c) the issuer reasonably believes its conflict

[899] This analysis has been prepared in accordance with 5 U.S.C. 601.

minerals came from recycled or scrap sources, then in all such cases the issuer must disclose its determination and describe briefly in the body of Form SD, the reasonable country of origin inquiry it undertook and the results of the inquiry. On the other hand, following its reasonable country of origin inquiry, if (a) the issuer knows that its conflict minerals originated in the Covered Countries and knows that they did not come from recycled or scrap sources, or the issuer has reason to believe that its conflict minerals may have originated in the Covered Countries, and (b) the issuer knows that its conflict minerals did not come from recycled or scrap sources or has reason to believe that its conflict minerals may not have come from recycled or scrap sources, then the issuer must exercise due diligence on the source and chain of custody of its conflict minerals that conforms to a nationally or internationally recognized due diligence framework, if one is available. If one is not available, the issuer must exercise due diligence without the benefit of such a framework. Following its due diligence, unless the issuer determines, based on that due diligence, that its conflict minerals did not originate in the Covered Countries or that its conflict minerals did come from recycled or scrap sources, the issuer must file a Conflict Minerals Report.

In most circumstances, the issuer must obtain an independent private sector audit of its Conflict Minerals Report. The issuer must also describe in its Conflict Minerals Report, among other information, its products manufactured or contracted to be manufactured that have not been found to be "DRC conflict free." For a temporary two-year period for all issuers, and for a temporary four-year period for smaller reporting issuers, an issuer that must perform due diligence and is unable to determine that the conflict minerals in its products originated in the Covered Countries or came from recycled or scrap sources, or unable to determine that the conflict minerals in those products that originated in the Covered Countries financed or benefited armed groups in those countries, may consider those products "DRC conflict undeterminable." In that case, the issuer must describe, among other information, its products manufactured or contracted to be manufactured that are "DRC conflict undeterminable" and the steps it has taken or will take, if any, since the end of the period covered in its most recent prior Conflict Minerals Report to mitigate the risk that its necessary conflict minerals benefit armed groups, including any steps to improve its due diligence. An issuer with products that are "DRC conflict undeterminable" is not required to obtain an independent private sector audit of the Conflict Minerals Report regarding the conflict minerals in those products.

Finally, after its reasonable country of origin inquiry, an issuer that has reason to believe that its conflict minerals may not have been from recycled or scrap sources must exercise due diligence that conforms to a nationally or internationally recognized due diligence framework developed specifically for conflict minerals from recycled sources to determine that its conflict minerals are from recycled or scrap sources. The issuer must also describe its due diligence in its Conflict Minerals Report. Currently, gold is the only conflict mineral with a nationally or internationally recognized due diligence framework for recycled or scrap conflict minerals. If no nationally or internationally recognized due diligence framework for a particular recycled or scrap conflict mineral is available, which is the case for the other three minerals, until such a framework is developed, the issuer must exercise due diligence in determining that its conflict minerals are from recycled or scrap sources and describe the due diligence measures it exercised in its Conflict Minerals Report.

### B. Significant Issues Raised by Public Comments

In the Proposing Release, we requested comment on any aspect of the IRFA, including the number of small entities that would be affected by the proposed rules, the nature of the impact, how to quantify the number of small entities that would be affected, and how to quantify the impact of the proposed rules. We received some comments that specifically referenced the Regulatory Flexibility Analysis ("RFA").[900] Some of these commentators claimed that we underestimated the number of small entities that would be impacted by the proposal because our estimate did not account for the number of small businesses that do not report with us but participate in a reporting issuer's supply chain.[901] In this regard, the SBA recommended that we publish an amended IFRA for the proposed rules to "more accurately reflect the costs of the proposed rule and the number of small businesses that it will affect."[902] Another commentator noted specifically that we must look beyond the 793 reporting issuers that are also small entities because, when an issuer seeks to establish whether its supply chain is free of conflict minerals, it will have to turn to its first-tier suppliers and require due diligence.[903] This commentator indicated, therefore, that "a large portion of America's 278 thousand small and medium-

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[900] See, e.g., letters from Industry Group Coalition II; IPC I; NAM I; Senator Olympia J. Snowe, Representative Sam Graves, Senator Scott P. Brown, Representative Roscoe Barlett, Representative Scott Tipton, and Representative Joe Walsh (Nov. 17, 2011) ("Sen. Snowe et al."); and the Small Business Administration's Office of Advocacy (Oct. 25, 2011) ("SBA").

[901] See, e.g., letters from NAM I, SBA, Sen. Snowe et al., and WGC II.

[902] See letter from SBA.

[903] See letter from NAM I.

sized manufacturers could be affected by" the final rule. Moreover, for purposes of determining the cost of the independent private sector audit on smaller companies, the commentator estimated that one in five smaller companies would be in an issuer's supply chain. As discussed in the Economic Analysis section above, we acknowledge that the statute and the final rule will affect many companies, including both companies that are directly subject to the rule's requirements and those that are not reporting companies but are part of a reporting issuer's supply chain.[904] For purposes of the RFA, however, the focus is the impact on entities on which our rules impose direct requirements.[905] Therefore, although we do acknowledge the rule's impact on non-reporting small entities, they were not included in our RFA estimate of the 793 small entities that would be directly subject to the final rule.

Additionally, several commentators addressed aspects of the proposed rules that could potentially affect smaller reporting companies or small companies generally.[906] These commentators did not clarify whether they were referring to "small entities" as that term is defined under Exchange Act Rule 0-10(a).[907] In particular, certain commentators

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[904] Id.

[905] See, e.g., Mid-Tex Electric Cooperative v. FERC, 773 F.2d 327 (DC Cir. 1985) and White Eagle Cooperative Ass'n v. Conner, 553 F.3d 467 (7th Cir. 2009). See also SMALL BUS. ADMIN., OFFICE OF ADVOCACY, A GUIDE FOR GOVERNMENT AGENCIES: HOW TO COMPLY WITH THE REGULATORY FLEXIBILITY ACT (June 2010) ("SBA Guidance"), available at http://archive.sba.gov/advo/laws/rfaguide.pdf.

[906] See, e.g., letters from BCIMC, Corporate Secretaries I, CRS I, Earthworks, Global Witness I, Howland, IPC I, JVC et al. II, NAM I, Rep. Bachus et al., Rockefeller, Sen. Durbin / Rep. McDermott, SIF I, State II, TIAA-CREF, TIC, TriQuint I, and WGC II.

[907] 17 CFR 240.0-10(a) (defining an issuer to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year).

argued that the costs of the rules could be disproportionally higher to smaller issuers.[908] One commentator suggested that the Conflict Minerals Statutory Provision "does create a burden on small businesses, but not as high or disproportionate to revenue as has been reported" by other commentators.[909] Also, as discussed above, one commentator argued that the final rule should exempt smaller reporting companies.[910] Many other commentators argued, however, that final rule should not exempt smaller reporting companies.[911] Many commentators indicated that exempting smaller reporting companies would not reduce significantly their burdens[912] because, among other reasons, many of these smaller companies are part of larger companies' supply chains and these larger companies would require the smaller companies to provide conflict minerals information so that the larger companies could meet their obligations under the rule.[913] Two commentators agreed that smaller reporting companies should not be exempt from the rule, but stated that they should be allowed to phase-in the rules to mitigate their costs and not drain their resources.[914]

### C. Small Entities Subject to the Final Rule

The final rule will affect some reporting issuers that are small entities. Exchange

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908 See, e.g., letters from Howland, NAM I, and WGC II.

909 See letter from Claigan IV.

910 See letter from Corporate Secretaries I.

911 See, e.g., letters from BCIMC, CRS I, Earthworks, Global Witness I, Howland, IPC I, JVC et al. II, Rockefeller, Sen. Durbin / Rep. McDermott, SIF I, State II, TIAA-CREF, TIC, and TriQuint I.

912 See, e.g., letters from IPC I and TriQuint I.

913 See letter from IPC I.

914 See letters from Howland and JVC et al. II.

Act Rule 0-10(a)[915] defines an issuer to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year. We believe that the final rule would affect small entities with necessary conflict minerals as defined under Exchange Act Section 13(p). In the Proposing Release, we estimated that there were approximately 793 issuers to which conflict minerals are necessary and that may be considered small entities. As discussed above some commentators indicated that we underestimated the number of small entities that would be impacted by the rule, but that was based on the assertion that we consider small entities that are not directly subject to the requirements of the final rule.[916] We note that no commentator provided any other number of small entities or disagreed that 793 is the number that will be directly subject to the final rule. We continue to believe that there are 793 small entities that file reports with us under Exchange Act Sections 13(a) and 15(d) and that will be directly subject to the final rule because they likely have conflict minerals necessary to the functionality or production of products they manufacture or contract to manufacture.

### D. Reporting, Recordkeeping, and Other Compliance Requirements

The final rule will add to the annual disclosure requirements of issuers with necessary conflict minerals, including small entities, by requiring them to comply with the disclosure and reporting obligations under Section 13(p) and provide certain additional disclosure in their new specialized disclosure reports on Form SD that certain

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[915] 17 CFR 240.0-10(a).

[916] See, e.g., letters from NAM I, SBA, and WGC II.

issuers will be required to file annually. Among other matters, that information must include, as applicable:

- disclosure in the body of the specialized disclosure report as to whether such issuer knows or has reason to believe that conflict minerals necessary to the functionality or production of a product manufactured or contracted by an issuer to be manufactured originated in the Covered Countries or may have originated in the Covered Countries and may not have come from recycled or scrap sources;
- if not, or if the issuer knows or has reason to believe that its necessary conflict minerals came from recycled or scrap sources, disclosure in the body of the specialized disclosure report and on the issuer's Internet website of that determination and a brief description of the reasonable country of origin inquiry used in making that determination and the results of the inquiry it performed, and disclosure in the body of the specialized disclosure report of the address of the issuer's Internet website where that information is publicly available;
- if so, and the issuer is able to determine whether its conflict minerals directly or indirectly financed or benefited armed groups in the Covered Countries
    - a Conflict Minerals Report filed as an exhibit to the specialized disclosure report, which includes a certified independent private sector audit report, a description of the nationally or internationally recognized due diligence framework the issuer used to determine the source and chain of custody of its conflict minerals, a description of the issuer's products that have not been found to be "DRC conflict free," and a description of the facilities used to process the necessary conflict minerals in those products, the

country of origin of the necessary conflict minerals in those products, and the efforts to determine the mine or location of origin with the greatest possible specificity;

disclosure in the body of the specialized disclosure report that a Conflict Minerals Report is filed as an exhibit to the specialized disclosure report and is publicly available on the issuer's Internet website, and disclosure within the body of the specialized disclosure report of the address of the issuer's Internet website on which the Conflict Minerals Report is publicly available;

- o posting of the Conflict Minerals Report on the issuer's publicly available Internet website.

- if so, but the issuer is unable to determine that its conflict minerals did not directly or indirectly finance or benefit armed groups in the Covered Countries, if the issuer has reason to believe that its conflict minerals may have originated in the Covered Countries but is unable to determine the origin,

  a Conflict Minerals Report filed as an exhibit to the specialized disclosure report that includes a description of the nationally or internationally recognized due diligence framework the issuer used to determine the source and chain of custody of its conflict minerals, a description of the facilities used to process the necessary conflict minerals in those products, if known, the country of origin of the necessary conflict minerals in those products, if known, and the efforts to determine the mine or location of origin with the greatest possible specificity, and, for a temporary period, a description of the issuer's products that are "DRC conflict undeterminable" (for the temporary period, such issuers are not required to have their Conflict Minerals Report audited regarding such minerals);

    - disclosure in the body of the specialized disclosure report that a Conflict Minerals Report is filed as an exhibit to the specialized disclosure report and is publicly available on the issuer's Internet website and the address of the issuer's Internet website on which the Conflict Minerals Report is publicly available;
    - posting of the Conflict Minerals Report on the issuer's publicly available Internet website.

- if there is reason to believe that the conflict minerals may not be from recycled or scrap sources and there is a nationally or internationally recognized due diligence framework for those particular conflict minerals,
    - a Conflict Minerals Report filed as an exhibit to the specialized disclosure report, which includes a description of the nationally or internationally recognized due diligence framework the issuer used to determine that those conflict minerals were or has reason to believe may have been from recycled or scrap sources, which includes a certified independent private sector audit report regarding those minerals;
    - disclosure in the body of the specialized disclosure report that a Conflict Minerals Report is filed as an exhibit to the specialized disclosure report and is publicly available on the issuer's Internet website and the address of the issuer's Internet website on which the Conflict Minerals Report is

publicly available.

- if there is reason to believe that the conflict minerals may not be from recycled or scrap sources but there is no nationally or internationally recognized due diligence framework for those particular conflict minerals,
  - o a Conflict Minerals Report filed as an exhibit to the specialized disclosure report, which includes a description of the due diligence the issuer used to determine that those conflict minerals were or has reason to believe may have been from recycled or scrap (until a nationally or internationally recognized due diligence framework is available for those conflict minerals from recycled or scrap sources, such issuers are not required to have their Conflict Minerals Report audited regarding such minerals);
  - o disclosure in the body of the specialized disclosure report that a Conflict Minerals Report is filed as an exhibit to the specialized disclosure report and is publicly available on the issuer's Internet website and the address of the issuer's Internet website on which the Conflict Minerals Report is publicly available.

The same disclosure and reporting requirements apply to U.S. and foreign issuers. However, under the final rule, issuers that proceed to step three but are unable to identify the origin of their conflict minerals or whether their conflict minerals came from recycled or scrap sources are required to provide a Conflict Minerals Report, but that report does not have to be audited for the first four years following the rule's adoption for smaller reporting companies. We are creating new Form SD that requires every issuer to file its conflict minerals information for each applicable calendar year on May 31 of the following year

### E. Agency Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives, while minimizing any significant adverse impact on small entities. In connection with the final rule, we considered the following alternatives:

(1) Establishing different compliance or reporting requirements which take into account the resources available to small entities;

(2) Exempting small entities from coverage of the disclosure requirements, or any part thereof;

(3) Clarification, consolidation, or simplification of the rules compliance and reporting requirements for small entities; and

(4) Use of performance standards rather than design standards.

We considered but did not establish different compliance requirements for small entities. As discussed above in response to commentators' suggestions that we exempt smaller reporting companies, we similarly believe that separate disclosure requirements for small entities that would differ from the final reporting requirements for other issuers, or exempting them from those requirements, would not achieve Congress's objectives of Section 13(p). The final rule is designed to implement the conflict minerals disclosure and reporting requirements of Section 13(p). That statutory section applies to all issuers with necessary conflict minerals, regardless of size. In any case, as several commentators noted, many smaller companies are part of larger companies' supply chains and would need to provide conflict minerals information so that the larger companies could meet their obligations under the rule.[917] However, under the final rule, issuers that proceed to step three but are unable to determine their conflict minerals originated in the Covered Countries or came from recycled or scrap sources, or unable to determine that the conflict minerals that originated in the Covered Countries financed or benefited armed groups in those countries are required to provide a Conflict Minerals Report, but that report does not have to be audited for the first four years following the rule's adoption for smaller reporting companies and the issuers may describe the product with known origin as "DRC conflict undeterminable."

We clarified and simplified aspects of the final rule for all issuers, including small entities. For example, the final rule specifies and clarifies the objective for the audit of a Conflict Minerals Report for newly-mined conflict minerals. The final rule also requires an issuer to disclose the information in the body of and as an exhibit to its specialized disclosure report, which may simplify the process of submitting the conflict minerals disclosure and Conflict Minerals Report as compared with requiring disclosure in an issuer's annual report on Form 10-K, Form 20-F, or Form 40-F.

We have generally used design rather than performance standards in connection with the final rule because we believe design standards will better accomplish Congress's objectives. The reasonable country of origin inquiry is the performance standard. In addition, the specific disclosure requirements in the final rule will promote consistent and comparable disclosure among all issuers with necessary conflict minerals. However, we

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917 See, e.g., letters from NAM I, SBA, Sen. Snowe et al., and WGC II.

are providing guidance regarding "contract to manufacture," and "necessary to the functionality and production," which we believe will allow issuers to comply with the statutory requirements in a manner more tailored to their individual circumstances.

## VI. STATUTORY AUTHORITY AND TEXT OF THE FINAL RULE

We are adopting the rule amendments contained in this document under the authority set forth in Sections 3(b), 12, 13, 15(d), 23(a), and 36 of the Exchange Act, as amended.

**List of Subjects**

17 CFR Parts 240 and 249b

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, we are amending Title 17, Chapter II of the Code of Federal Regulations as follows:

**PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

1. The authority citation for part 240 is amended by adding an authority for §240.13p-1 in numerical order to read as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77jjj, 77kkk, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78 *l*, 78m, 78n, 78n–1, 78o, 78o–4, 78o–8, 78p, 78q, 78s, 78u–5, 78w, 78x, 78dd(b), 78dd(c), 78 *ll*, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, 7201 *et seq.*, and 8302; 18 U.S.C. 1350; 12 U.S.C. 5221(e)(3), and Pub. L. 111–203, Sec. 712, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

Section 240.13p-1 is also issued under sec. 1502, Pub. L. No. 111-203, 124 Stat.

1376.

* * * * *

2. Add § 240. 13p-1 to read as follows:

**§ 240.13p-1 Requirement of Report Regarding Disclosure of registrant's supply chain information regarding conflict minerals.**

Every registrant that files reports with the Commission under Sections 13(a) (15 U.S.C. 78m(a)) or 15(d) (15 U.S.C. 78o(d)) of the Exchange Act, having conflict minerals that are necessary to the functionality or production of a product manufactured or contracted by that registrant to be manufactured, shall file a report on Form SD within the period specified in that Form disclosing the information required by the applicable items of Form SD as specified in that Form (17 CFR 249b.400).

**PART 249b—FURTHER FORMS, SECURITIES EXCHANGE ACT OF 1934**

3. The authority citation for part 249b is amended by adding an authority for §249b.400 to read as follows:

Authority: 15 U.S.C. 78a et seq., unless otherwise noted.

* * * * *

Section 249b.400 is also issued under secs. 1502, Pub. L. No. 111-203, 124 Stat. 2213.

4. Add §249b.400 to read as follows:

**§ 249b.400 Form SD, specialized disclosure report.**

This Form shall be filed pursuant to §240.13p-1 of this chapter by registrants that file reports with the Commission pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934 and are required to disclose the information required by Section 13(p) under the Securities Exchange Act of 1934 and Rule 13p-1 (§240.13p-1) of this chapter.

5. Add Form SD (referenced in §249b.400) to read as follows:

**Note: The text of Form SD does not appear in the Code of Federal Regulations.**

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

**FORM SD**

**SPECIALIZED DISCLOSURE REPORT**

____________________________________________
(Exact name of the registrant as specified in its charter)

____________________________________________

| (State or other jurisdiction of incorporation or organization) | (Commission File Number) | (IRS Employer Identification No.) |
|---|---|---|

____________________________________________

(Address of principal executive offices) (Zip code)

____________________________________________

(Name and telephone number, including area code, of the person to contact in connection with this report.)

Check the appropriate box to indicate the rule pursuant to which this form is being filed, and provide the period to which the information in this form applies:

____ Rule 13p-1 under the Securities Exchange Act (17 CFR 240.13p-1) for the reporting period from January 1 to December 31, ______.

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**GENERAL INSTRUCTIONS**

**A. Rule as to Use of Form SD.**

This form shall be used for a report pursuant to Rule 13p-1 (17 CFR 240.13p-1) under the Exchange Act.

**B. Information to be Reported and Time for Filing of Reports.**

1. Form filed under Rule 13p-1. A report on this Form shall be filed on EDGAR no later than May 31 after the end of the issuer's most recent calendar year.

2. If the deadline for filing this form occurs on a Saturday, Sunday or holiday on which the Commission is not open for business, then the deadline shall be the next business day.

**C. Inapplicability to Registered Investment Companies.**

The disclosures required in Form SD shall not apply to investment companies required to file reports pursuant to Rule 30d-1 (17 CFR 270.30d-1) under the Investment Company Act of 1940.

**D. Preparation of Report.**

This form is not to be used as a blank form to be filled in, but only as a guide in the preparation of the report meeting the requirements of Rule 12b-12 (17 CFR 240.12b-12). The report shall contain the number and caption of the applicable item, but the text of such item may be omitted, provided the answers thereto are prepared in the manner specified in Rule 12b-13 (17 CFR 240.12b-13). All items that are not required to be answered in a particular report may be omitted and no reference thereto need be made in the report. All instructions should also be omitted.

**E. Application of General Rules and Regulations.**

The General Rules and Regulations under the Act (17 CFR Part 240) contain certain general requirements which are applicable to reports on any form. These general requirements should be carefully read and observed in the preparation and filing of reports on this form.

**F. Signature and Filing of Report**

The report must be signed by the registrant on behalf of the registrant by an executive officer.

## INFORMATION TO BE INCLUDED IN THE REPORT

**Section 1 - Conflict Minerals Disclosure**

**Item 1.01 Conflict Minerals Disclosure and Report**

(a) If any conflict minerals, as defined by paragraph (d)(3) of this item, are necessary to the functionality or production of a product manufactured by the registrant or contracted by the registrant to be manufactured and are required to be reported in the calendar year covered by the specialized disclosure report, the registrant must conduct in good faith a reasonable country of origin inquiry regarding those conflict minerals that is reasonably designed to determine whether any of the conflict minerals originated in the Democratic Republic of the Congo or an adjoining country, as defined by paragraph (d)(1) of this item, or are from recycled or scrap sources, as defined by paragraph (d)(6) of this item.

(b) Based on its reasonable country of origin inquiry, if the registrant determines that its necessary conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country or did come from recycled or scrap sources, or if it has no reason to believe that its necessary conflict minerals may have originated in the Democratic Republic of the Congo or an adjoining country, or if based on its reasonable country of origin inquiry the registrant reasonably believes that its necessary conflict minerals did come from recycled or scrap sources, the registrant must, in the body of its specialized disclosure report under a separate heading entitled "Conflict Minerals Disclosure," disclose its determination and briefly describe the reasonable country of origin inquiry it undertook in making its determination and the results of the inquiry it performed. Also, the registrant must disclose this information on its publicly available Internet website and, under a separate heading in its specialized disclosure report entitled "Conflict Minerals Disclosure," provide a link to that website.

(c) Alternatively, based on its reasonable country of origin inquiry, if the registrant knows that any of its necessary conflict minerals originated in the Democratic Republic of the Congo or an adjoining country and are not from recycled or scrap sources, or has reason to believe that its necessary conflict minerals may have originated in the Democratic Republic of the Congo or an adjoining country and has reason to believe that they may not be from recycled or scrap sources, the registrant must exercise due diligence on the source and chain of custody of its conflict mineral, as discussed in paragraph (c)(1) of this item, that conforms to a nationally or internationally recognized due diligence framework, if such a framework is available for the conflict mineral. If, as a result of that due diligence, the registrant determines that its conflict minerals did <u>not</u> originate in the Democratic Republic of the Congo or an adjoining country or the registrant determines that its conflict minerals <u>did</u> come from recycled or scrap sources, a Conflict Minerals Report is not required, but the registrant must disclose its determination and briefly describe, in the body of its specialized disclosure report under a separate heading entitled "Conflict Minerals Disclosure," the reasonable country of origin inquiry and the due diligence efforts it undertook in making its determination and the results of the inquiry and due diligence efforts it performed. Also, the registrant must disclose this information on its publicly available Internet website and, under a separate heading in its specialized disclosure report entitled "Conflict Minerals Disclosure," provide a link to that website. Otherwise, the registrant must file a Conflict Minerals Report as an exhibit to its specialized disclosure report and provide that report on its publicly available Internet website. Under a separate heading in its specialized disclosure report entitled "Conflict Minerals Disclosure," the registrant must disclose that it has filed a Conflict Minerals Report and provide the link to its Internet website where the Conflict Minerals Report is publicly available.

The Conflict Minerals Report must include the following information:

(1) Due Diligence: A description of the measures the registrant has taken to exercise due diligence on the source and chain of custody of those conflict minerals;

(i) The registrant's due diligence must conform to a nationally or internationally recognized due diligence framework, if such a framework is available for the conflict mineral;

(ii) Except as provided in paragraphs (c)(1)(iv), (c)(1)(v), and (c)(1)(vi) of this item, the due diligence measures shall include but not be limited to an independent private sector audit of the Conflict Minerals Report that is conducted in accordance with standards established by the Comptroller General of the United States and certified pursuant to paragraph (c)(1)(ii)(B) of this item, which shall constitute a critical component of the registrant's due diligence in establishing the source and chain of custody of the necessary conflict minerals.

(A) The objective of the audit of the Conflict Minerals Report is to express an opinion or conclusion as to whether the design of the registrant's due diligence measures as set forth in, and with respect to the period covered by, the registrant's Conflict Minerals Report, is in conformity with, in all material respects, the criteria set forth in the nationally or internationally recognized due diligence framework used by the registrant, and whether the registrant's description of the due diligence measures it performed as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is consistent with the due diligence process that the registrant undertook.

(B) The registrant's Conflict Minerals Report must include a statement that the registrant has obtained an independent private sector audit of the Conflict Minerals Report, which shall constitute an audit certification;

(C) As part of the Conflict Minerals Report, the registrant must identify the independent private sector auditor of the report, if the auditor is not identified in the audit report, and provide the audit report prepared by the auditor in accordance with standards established by the Comptroller General of the United States;

(iii) Any registrant that manufactures products or contracts for products to be manufactured that are "DRC conflict undeterminable," as defined in paragraph (d)(5) of this item, must disclose the steps it has taken or will take, if any, since the end of the period covered in its most recent prior Conflict Minerals Report to mitigate the risk that its necessary conflict minerals benefit armed groups, including any steps to improve its due diligence.

(iv) For the temporary period specified in Instruction 2 to Item 1.01, following its exercise of appropriate due diligence, a registrant with products that are "DRC conflict undeterminable" is not required to obtain an independent private sector audit of its

Conflict Minerals Report regarding the conflict minerals that the registrant is unable to determine did not originate in the Democratic Republic of the Congo or an adjoining country, or that the registrant is unable to determine did not directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country.

(v) If a nationally or internationally recognized due diligence framework does not exist for a necessary conflict mineral, until such a framework is developed, the registrant is required to exercise appropriate due diligence in determining the source and chain of custody of the necessary conflict mineral, including whether the conflict mineral is from recycled or scrap sources, without the benefit of a due diligence framework. If a nationally or internationally recognized due diligence framework becomes available for the necessary conflict mineral prior to June 30 of a calendar year, the registrant must use that framework in the subsequent calendar year. If the due diligence guidance does not become available until after June 30 of a calendar year, the registrant is not required to use that framework until the second calendar year after the framework becomes available to provide a full calendar year before implementation. If no nationally or internationally recognized due diligence framework is available for a particular conflict mineral from recycled or scrap sources, the due diligence inquiry regarding the conflict mineral focuses on whether the conflict mineral is from recycled or scrap sources. In addition, an independent private sector audit will not be required for the section of the Conflict Minerals Report pertaining to the registrant's due diligence on that recycled or scrap conflict mineral.

(vi) If the registrant performs due diligence because it has a reason to believe that its conflict minerals originated in the Democratic Republic of the Congo or an adjoining country, and as a result of that due diligence it determines that its conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country (or it determines as a result of that due diligence that its necessary conflict minerals did come from recycled or scrap sources), a Conflict Minerals Report and an audit is not required.

(2) Product Description: Any registrant that manufactures products or contracts for products to be manufactured that have not been found to be "DRC conflict free," as defined in paragraph (d)(4) of this item, must provide a description of those products, the facilities used to process the necessary conflict minerals in those products, the country of origin of the necessary conflict minerals in those products, and the efforts to determine the mine or location of origin with the greatest possible specificity.

(i) For the temporary period specified in Instruction 2 to Item 1.01, following its exercise of appropriate due diligence, any registrant that manufactures products or contracts for products to be manufactured that are "DRC conflict undeterminable" must provide a description of those products, the facilities used to process the necessary conflict minerals in those products, if known, the country of origin of the necessary conflict minerals in those products, if known, and the efforts to determine the mine or location of origin with the greatest possible specificity;

(ii) A registrant is not required to provide the information in paragraph (c)(2) of this item if the necessary conflict minerals in its product are solely from recycled or scrap sources because those products are considered "DRC conflict free."

(d) For the purposes of this item, the following definitions apply:

(1) Adjoining country. The term adjoining country means a country that shares an internationally recognized border with the Democratic Republic of the Congo.

(2) Armed group. The term armed group means an armed group that is identified as a perpetrator of serious human rights abuses in annual Country Reports on Human Rights Practices under sections 116(d) and 502B(b) of the Foreign Assistance Act of 1961 (22 U.S.C. 2151n(d) and 2304(b)) relating to the Democratic Republic of the Congo or an adjoining country.

(3) Conflict mineral. The term conflict mineral means:

(i) Columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives, which are limited to tantalum, tin, and tungsten, unless the Secretary of State determines that additional derivatives are financing conflict in the Democratic Republic of the Congo or an adjoining country; or

(ii) 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.

(4) DRC conflict free. The term DRC conflict free means that a product does not contain conflict minerals necessary to the functionality or production of that product that directly or indirectly finance or benefit armed groups, as defined in paragraph (d)(2) of this item, in the Democratic Republic of the Congo or an adjoining country. Conflict minerals that a registrant obtains from recycled or scrap sources, as defined in paragraph (d)(6) of this item, are considered DRC conflict free.

(5) DRC conflict undeterminable. The term DRC conflict undeterminable means, with respect to any product manufactured or contracted to be manufactured by a registrant, that the registrant is unable to determine, after exercising due diligence as

required by paragraph (c)(1) of this item, whether or not such product qualifies as DRC conflict free.

(6) Conflict Minerals from Recycled or Scrap Sources. Conflict minerals are considered to be from recycled or scrap sources if they are from recycled metals, which are reclaimed end-user or post-consumer products, or scrap processed metals created during product manufacturing. Recycled metal includes excess, obsolete, defective, and scrap metal materials that contain refined or processed metals that are appropriate to recycle in the production of tin, tantalum, tungsten and/or gold. Minerals partially processed, unprocessed, or a bi-product from another ore will not be included in the definition of recycled metal.

(7) Outside the Supply Chain. A conflict mineral is considered outside the supply chain after any columbite-tantalite, cassiterite, and wolframite minerals, or their derivatives, have been smelted; any gold has been fully refined; or any conflict mineral, or its derivatives, that have not been smelted or fully refined are located outside of the Democratic Republic of the Congo or an adjoining country.

(8) Nationally or internationally recognized due diligence framework. The term "nationally or internationally recognized due diligence framework" means a nationally or internationally recognized due diligence framework established following due-process procedures, including the broad distribution of the framework for public comment, and is consistent with the criteria standards in the Government Auditing Standards established by the Comptroller General of the United States.

**Item 1.02 Exhibit**

Registrants shall file, as an exhibit to this Form SD, the Conflict Minerals Report required by Item 1.01.

Instructions to Item 1.01

(1) A registrant that mines conflict minerals would not be considered to be manufacturing those minerals for the purpose of this item. The specialized disclosure report on Form SD shall cover a calendar year, regardless of the registrant's fiscal year, and be due annually on May 31 for the prior calendar year.

(2) During the first two calendar years following **[add effectiveness date]** for all registrants and the first four calendar years for any smaller reporting company, a registrant will not be required to submit an audit report of its Conflict Minerals Report prepared by an independent private sector auditor with respect to the conflict minerals in any of its products that are "DRC conflict undeterminable." Beginning with the third or fifth reporting calendar year, as applicable, a registrant with products manufactured or contracted to be manufactured that are "DRC conflict undeterminable," must describe those products as having not been found to be "DRC conflict free" and must provide the information required in paragraph (c) of this item including the audit report.

(3) A registrant that acquires or otherwise obtains control over a company that manufactures or contracts to manufacture products with conflict minerals necessary to the functionality or production of those products that previously had not been obligated to provide a specialized disclosure report with respect to its conflict minerals will be permitted to delay reporting on the products manufactured by the acquired company until the end of the first reporting calendar year that begins no sooner than eight months after the effective date of the acquisition.

(4) A registrant is not required to provide any information regarding its

conflict minerals that, prior to January 31, 2013, are located outside of the supply chain, as defined by paragraph (d)(7) of this item.

(5) A registrant must provide its required conflict minerals information for the calendar year in which the manufacture of a product that contains any conflict minerals necessary to the functionality or production of that product is completed, irrespective of whether the registrant manufactures the product or contracts to have the product manufactured.

**Section 2 - Exhibits**

**Item 2.01 Exhibits**

List below the following exhibit filed as part of this report.

Exhibit 1.01 – Conflict Minerals Report as required by Items 1.01 and 1.02 of this Form.

* * * * *

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the duly authorized undersigned.

______________________________
(Registrant)

______________________________ ______________________________
By (Signature and Title)* (Date)

*Print name and title of the registrant's signing executive officer under his or her signature.

* * * * *

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy

Secretary

Dated: August 22, 2012

Chairman Schapiro
Commissioner Paredes
not participating
Commissioner Gallagher
Disapproved

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Parts 240 and 249**

**[RELEASE NO. 34-67717; FILE NO. S7-42-10]**

**RIN 3235-AK85**

**DISCLOSURE OF PAYMENTS BY RESOURCE EXTRACTION ISSUERS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** We are adopting new rules and an amendment to a new form pursuant to Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to disclosure of payments by resource extraction issuers. Section 1504 added Section 13(q) to the Securities Exchange Act of 1934, which requires the Commission to issue rules requiring resource extraction issuers to include in an annual report information relating to any payment made by the issuer, a subsidiary of the issuer, or an entity under the control of the issuer, to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals. Section 13(q) requires a resource extraction issuer to provide information about the type and total amount of such payments made for each project related to the commercial development of oil, natural gas, or minerals, and the type and total amount of payments made to each government. In addition, Section 13(q) requires a resource extraction issuer to provide information regarding those payments in an interactive data format.

DATES:

**Effective Date:** [insert date 60 days after publication in the Federal Register]

**Compliance Date:** A resource extraction issuer must comply with the new rules and form for fiscal years ending after September 30, 2013. For the first report filed for fiscal years ending after September 30, 2013, a resource extraction issuer may provide a partial year report if the issuer's fiscal year began before September 30, 2013. The issuer will be required to provide a report for the period beginning October 1, 2013 through the end of its fiscal year. For any fiscal year beginning on or after September 30, 2013, a resource extraction issuer will be required to file a report disclosing payments for the full fiscal year.

**FOR FURTHER INFORMATION CONTACT:** Tamara Brightwell, Senior Special Counsel, Division of Corporation Finance, Elliot Staffin, Special Counsel, Office of International Corporate Finance, Division of Corporation Finance, or Eduardo Aleman, Special Counsel, Office of Rulemaking, Division of Corporation Finance, at (202) 551-3290, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-4553.

**SUPPLEMENTARY INFORMATION:** We are adopting new Rule 13q-1[1] and an amendment to new Form SD[2] under the Securities Exchange Act of 1934 ("Exchange Act").[3]

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1 17 CFR 240.13q-1.

2 17 CFR 249.448.

3 15 U.S.C. 78a et seq.

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## I. BACKGROUND

On December 15, 2010, we proposed rule and form amendments[4] under the Exchange Act to implement Section 13(q) of the Exchange Act, which was added by Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Act").[5] Section 13(q) requires the Commission to "issue final rules that require each resource extraction issuer to include in an annual report of the resource extraction issuer information relating to any payment made by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals, including – (i) the type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals, and (ii) the type and total amount of such payments made to each government."[6]

Based on the legislative history, we understand that Congress enacted Section 1504 to increase the transparency of payments made by oil, natural gas, and mining companies to governments for the purpose of the commercial development of their oil, natural gas, and minerals. A primary goal of such transparency is to help empower citizens of those resource-

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4 See Exchange Act Release No. 63549 (December 15, 2010), 75 FR 80978 (December 23, 2010), available at http://www.sec.gov/rules/proposed/2010/34-63549.pdf ("Proposing Release").

5 Pub. L. No. 111-203 (July 21, 2010).

6 15 U.S.C. 78m(q)(2)(A). As discussed further below, Section 13(q) also specifies that the Commission's rules must require certain information to be provided in interactive data format.

rich countries to hold their governments accountable for the wealth generated by those resources.[7] To accomplish this goal, Congress created a disclosure regime under the Exchange Act that would support the commitment of the U.S. Federal Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals.[8]

Section 13(q) provides the following definitions and descriptions of several key terms:

- "resource extraction issuer" means an issuer that is required to file an annual report with the Commission and engages in the commercial development of oil, natural gas, or minerals;[9]
- "commercial development of oil, natural gas, or minerals" includes exploration, extraction, processing, export, and other significant actions relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity, as determined by the Commission;[10]

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7 See, e.g., statement by Senator Richard Lugar, one of the sponsors of Section 1504 ("Adoption of the Cardin-Lugar amendment would bring a major step in favor of increased transparency at home and abroad. . . .More importantly, it would help empower citizens to hold their governments to account for the decisions made by their governments in the management of valuable oil, gas, and mineral resources and revenues. . . .The essential issue at stake is a citizen's right to hold its government to account. Americans would not tolerate the Congress denying them access to revenues our Treasury collects. We cannot force foreign governments to treat their citizens as we would hope, but this amendment would make it much more difficult to hide the truth."), 156 CONG. REC. S3816 (May 17, 2010).

8 See 15 U.S.C. 78m(q)(2)(E).

9 15 U.S.C. 78m(q)(1)(D).

10 15 U.S.C. 78m(q)(1)(A).

- "foreign government" means a foreign government, a department, agency or instrumentality of a foreign government, or a company owned by a foreign government, as determined by the Commission;[11] and
- "payment" means a payment that:
  - is made to further the commercial development of oil, natural gas, or minerals;
  - is not de minimis; and
  - includes taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits, that the Commission, consistent with the guidelines of the Extractive Industries Transparency Initiative (to the extent practicable), determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.[12]

Section 13(q) specifies that "[t]o the extent practicable, the rules issued under [the section] shall support the commitment of the Federal Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals."[13] As noted above, the statute explicitly refers to one international initiative, the Extractive Industries Transparency Initiative ("EITI"),[14] in the definition of "payment."

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[11] 15 U.S.C. 78m(q)(1)(B).

[12] 15 U.S.C. 78m(q)(1)(C).

[13] 15 U.S.C. 78m(q)(2)(E).

[14] The EITI is a voluntary coalition of oil, natural gas, and mining companies, foreign governments, investor groups, and other international organizations dedicated to fostering and improving transparency and accountability in countries rich in oil, natural gas, and minerals through the publication and verification of company payments and government revenues from oil, natural gas, and mining. See Implementing the Extractive Industries Transparency Initiative (2008) ("Implementing

Although a separate provision in Section 13(q) regarding international transparency efforts does not explicitly mention the EITI, the legislative history indicates that the EITI was

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the EITI"), available at http://eiti.org/document/implementingtheeiti. According to the EITI, "[b]y encouraging greater transparency and accountability in countries dependent on the revenues from oil, gas and mining, the potential negative impacts of mismanaged revenues can be mitigated, and these revenues can instead become an important engine for long-term economic growth that contributes to sustainable development and poverty reduction." EITI Source Book (2005), at 4, available at http://eiti.org/files/document/sourcebookmarch05.pdf. Announced by former UK Prime Minister Tony Blair at the World Summit on Sustainable Development in Johannesburg in September 2002, the EITI received the endorsement of the World Bank Group in 2003. See History of EITI, http://www.eiti.org/eiti/history (last visited August 15, 2012).

Currently 14 countries –Azerbaijan, Central African Republic, Ghana, Kyrgyz Republic, Liberia, Mali, Mauritania, Mongolia, Niger, Nigeria, Norway, Peru, Timor Leste, and Yemen – have achieved "EITI compliant" status by completing a validation process in which company payments are matched with government revenues by an independent auditor. See http://eiti.org/countries/compliant (last visited August 15, 2012). Some 22 other countries are EITI candidates in the process of complying with EITI standards, although one of the countries, Madagascar, recently had its EITI candidate status suspended. See http://eiti.org/candidatecountries (last visited August 15, 2012). Several other countries have indicated their intent to implement the EITI. See http://eiti.org/othercountries. Implementation of the EITI varies across countries – the EITI provides criteria and a framework for implementation, but allows countries to make key decisions on the scope of its program (e.g., degree of aggregation of data, inclusion of subnational or social or community payments). See Implementing the EITI, at 23-24.

On September 20, 2011, President Obama declared that the United States will join the global initiative and released a National Action Plan stating that the Administration is committing to implement the EITI. See http://www.whitehouse.gov/the-press-office/2011/09/20/opening-remarks-president-obama-open-government-partnership and http://www.whitehouse.gov/sites/default/files/us_national_action_plan_final_2.pdf. The U.S. Department of the Interior ("DOI") is responsible for implementing the U.S. EITI. See "White House Announces Secretary Ken Salazar as Senior Official Responsible for Oversight of Implementation of Extractive Industries Transparency Initiative," White House Statements and Releases (October 25, 2011), available at http://www.whitehouse.gov/the-press-office/2011/10/25/white-house-announces-secretary-ken-salazar-administrations-senior-offic. After soliciting comment on and evaluating comments regarding the formation of the multi-stakeholder group for the U.S. EITI, the DOI announced that the assessment phase of the U.S. EITI implementation was complete, and the next phase of the U.S. EITI implementation will involve establishing the multi-stakeholder group. See "U.S. Department of the Interior Announces Results of USEITI Implementation Assessment," U.S. Department of the Interior News Release (July 10, 2012), available at http://www.doi.gov/EITI/index.cfm. See also letter from Batirente Inc. and NEI Investments (February 10, 2012) ("Batirente and NEI Investments") (submitting a copy of a statement by 17 Canadian investment institutions calling on the Canadian government to become an EITI implementing country). One commentator indicated that the final rules should be "aligned and coordinated" with the process being developed by the DOI to fulfill the United States' commitment to implementing the EITI. See letter from NMA 3.

considered in connection with the new statutory provision.[15] The United States is one of several countries that supports the EITI.[16]

The Commission's rules under Section 13(q) must require a resource extraction issuer to submit the payment information included in an annual report in an interactive data format[17] using an interactive data standard established by the Commission.[18] Section 13(q) defines "interactive data format" to mean an electronic data format in which pieces of information are identified using an interactive data standard.[19] The section also defines "interactive data standard" as a standardized list of electronic tags that mark information

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15 See, e.g., statement by Senator Lugar ("This domestic action will complement multilateral transparency efforts such as the Extractive Industries Transparency Initiative – the EITI – under which some countries are beginning to require all extractive companies operating in their territories to publicly report their payments."), 111 Cong. Rec. S3816 (daily ed. May 17, 2010). Other examples of international transparency efforts include the amendments of the Hong Kong Stock Exchange listing rules for mineral companies and the London Stock Exchange AIM rules for extractive companies. See Amendments to the GEM Listing Rules of the Hong Kong Stock Exchange, Chapter 18A.05(6)(c) (effective June 3, 2010), available at http://www.hkex.com.hk/eng/rulesreg/listrules/gemrulesup/Documents/gem34_miner.pdf (requiring a mineral company to include in its listing document, if relevant and material to the company's business operations, information regarding its compliance with host country laws, regulations and permits, and payments made to host country governments in respect of tax, royalties, and other significant payments on a country by country basis) and Note for Mining and Oil & Gas Companies – June 2009, available at http://www.londonstockexchange.com/companies-and-advisors/aim/advisers/rules/guidance-note.pdf (requiring disclosure in the initial listing of "any payments aggregating over £10,000 made to any government or regulatory authority or similar body made by the applicant or on behalf of it, in regards to the acquisition of, or maintenance of its assets.").

16 See the list of EITI supporting countries, available at http://eiti.org/supporters/countries (last visited August 15, 2012).

17 15 U.S.C. 78m(q)(2)(C).

18 15 U.S.C. 78m(q)(2)(D).

19 15 U.S.C. 78m(q)(1)(E).

included in the annual report of a resource extraction issuer.[20] The rules issued pursuant to Section 13(q)[21] must include electronic tags that identify:

- the total amounts of the payments, by category;
- the currency used to make the payments;
- the financial period in which the payments were made;
- the business segment of the resource extraction issuer that made the payments;
- the government that received the payments and the country in which the government is located; and
- the project of the resource extraction issuer to which the payments relate.[22]

Section 13(q) further authorizes the Commission to require electronic tags for other information that it determines is necessary or appropriate in the public interest or for the protection of investors.[23]

Section 13(q) provides that the final rules "shall take effect on the date on which the resource extraction issuer is required to submit an annual report relating to the fiscal year...that ends not earlier than 1 year after the date on which the Commission issues final rules[.]"[24]

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20 15 U.S.C. 78m(q)(1)(F).

21 15 U.S.C. 78m(q)(2)(D)(i).

22 15 U.S.C. 78m(q)(2)(D)(ii).

23 15 U.S.C. 78m(q)(2)(D)(ii).

24 15 U.S.C. 78m(q)(2)(F).

Finally, Section 13(q) requires, to the extent practicable, the Commission to make publicly available online a compilation of the information required to be submitted by resource extraction issuers under the new rules.[25] The statute does not define the term compilation.

The Commission received over 150 unique comment letters on the proposal as well as over 149,000 form letters (including a petition with 143,000 signatures).[26] These letters came from corporations in the resource extraction industries, industry and professional associations, United States and foreign government officials, non-governmental organizations, law firms, pension and other investment funds, academics, investors, a labor union and other employee groups, and other interested parties. Commentators generally supported transparency efforts and offered numerous suggestions for revising certain aspects of the proposal in the final rules.

We have reviewed and considered all of the comments that we received and the rules we are adopting reflect changes made in response to many of the comments. Generally, as adopted, the final rules track the language in the statute, and except for where the language or approach of Section 13(q) clearly deviates from the EITI, the final rules are consistent with

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25 15 U.S.C. 78m(q)(3).

26 The letters, including the form letters designated as Type A, Type B, and Type C, are available at http://www.sec.gov/comments/s7-42-10/s74210.shtml. In addition, to facilitate public input on the Act, the Commission provided a series of e-mail links, organized by topic, on its website at http://www.sec.gov/spotlight/regreformcomments.shtml. The public comments we received on Section 1504 of the Act, which were submitted prior to the Proposing Release, are available on our website at http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specialized-disclosures.shtml. Many commentators provided comments both prior to, and in response to, the proposal. Generally, our references to comment letters refer to the comments submitted in response to the proposal. When we refer to a comment letter submitted prior to the proposal, however, we make that clear in the citation.

the EITI.[27] In instances where the language or approach of Section 13(q) clearly deviates from the EITI, the final rules track the statute rather than the EITI because in those instances we believe Congress intended the final rules to go beyond what is required by the EITI. We believe this approach is consistent with Section 13(q) and furthers the statutory goal to support international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals because the EITI is referenced in Section 13(q) and is well-recognized for promoting such transparency.[28]

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27 A country volunteers to become an EITI member. To become an EITI member country, among other things, a country must establish a multi-stakeholder group, including representatives of civil society, industry, and government, to oversee implementation of the EITI. The stakeholder group for a particular country agrees to the terms of that country's EITI plan, including the requirements for what information will be provided by the governments and by the companies operating in that country. Generally, as we understand it, under the EITI, companies and the host country's government submit payment information confidentially to an independent administrator selected by the country's multi-stakeholder group, which is frequently an independent auditor. The auditor reconciles the information provided to it by the government and by the companies and produces a report. The information provided in the reports varies widely among countries. A country must complete an EITI validation process to become a compliant member. The EITI Source Book and Implementing the EITI provide guidance regarding what should be included in a country's EITI plan, and we have looked to those materials and to the reports made by EITI member countries for guidance as to EITI requirements. See the EITI's website at http://eiti.org.

28 See Exchange Act Sections 13(q)(2)(C)(ii) and 13(q)(2)(E) [15 U.S.C. 78m(q)(2)(C)(ii) and 78m(q)(2)(E)].

## II. FINAL RULES IMPLEMENTING SECTION 13(q)

### A. Summary of the Final Rules

Consistent with the proposal, we are adopting final rules that define the term "resource extraction issuer" as defined in Section 13(q). As proposed, the final rules will apply to all U.S. companies and foreign companies that are engaged in the commercial development of oil, natural gas, or minerals, and that are required to file annual reports with the Commission, regardless of the size of the company or the extent of business operations constituting commercial development of oil, natural gas, or minerals. Consistent with the proposal, the final rules will apply to an issuer, whether government-owned or not, that meets the definition of resource extraction issuer.

Consistent with the proposal and in light of the structure, language, and purpose of the statute, the final rules do not provide any exemptions from the disclosure requirements. As such, the final rules do not include an exemption for certain categories of issuers or for resource extraction issuers subject to similar reporting requirements under home country laws, listing rules, or an EITI program. The final rules also do not provide an exemption for situations in which foreign law may prohibit the required disclosure. In addition, the final rules do not provide an exemption for instances when an issuer has a confidentiality provision in an existing or future contract or for commercially sensitive information.

Consistent with Section 13(q) and the proposal, the final rules define "commercial development of oil, natural gas, or minerals" to include the activities of exploration, extraction, processing, and export, or the acquisition of a license for any such activity.

Consistent with Section 13(q) and the proposal, the final rules define "payment" to mean a payment that is made to further the commercial development of oil, natural gas, or minerals, is "not de minimis," and includes taxes, royalties, fees (including license fees), production entitlements, and bonuses. After considering the comments, under the final rules and in accordance with Section 13(q)(1)(C)(ii), we also are including dividends and payments for infrastructure improvements in the list of payments required to be disclosed. The final rules include instructions to clarify the types of taxes, fees, bonuses, and dividends that are covered. In addition, after considering the comments, we have determined to define the term "not de minimis." Unlike the proposed rules, which left the term "not de minimis" undefined, the final rules define "not de minimis" to mean any payment, whether a single payment or a series of related payments, that equals or exceeds $100,000 during the most recent fiscal year.

Consistent with Section 13(q) and the proposal, after considering the comments, we have decided to leave the term "project" undefined.

Consistent with the proposal, the final rules require a resource extraction issuer to disclose payments made by the issuer, a subsidiary of the issuer, or an entity under the control of the issuer to a foreign government or the U.S. Federal Government for the purpose of commercial development of oil, natural gas, or minerals. A resource extraction issuer will be required to disclose payments made directly, or by any subsidiary, or entity under the control of the resource extraction issuer. Therefore, a resource extraction issuer must disclose payments made by a subsidiary or entity under the control of the resource extraction issuer where the subsidiary or entity is consolidated in the resource extraction issuer's financial statements included in its Exchange Act reports, as well as payments by other entities it controls as determined in accordance with Rule 12b-2. A resource extraction issuer may be required to provide the disclosure for entities in which it provides proportionately consolidated information. A resource extraction issuer will be required to determine whether it has control of an entity for purposes of the final rules based on a consideration of all relevant facts and circumstances.[29]

We are adopting the definition of "foreign government" consistent with the definition in Section 13(q), as proposed. A "foreign government" includes a foreign national government as well as a foreign subnational government, such as the government of a state, province, county, district, municipality, or territory under a foreign national government. As proposed, the final rules clarify that "Federal Government" means the United States Federal Government. The final rules do not require disclosure of payments made to subnational governments in the United States. Consistent with the proposal, the final rules clarify that a company owned by a foreign government is a company that is at least majority-owned by a foreign government.

After considering the comments, the final rules we are adopting require resource extraction issuers to provide the required disclosure about payments in a new annual report, rather than in the issuer's existing Exchange Act annual report as proposed. We are adopting amendments to new Form SD to require the disclosure.[30] Similar to the proposal, the Form

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[29] See Exchange Act Rule 12b-2 for the definition of "control." See also note 315.

[30] In another release we are issuing today, we are adopting rules to implement the requirements of Section 1502 of the Dodd-Frank Act and requiring issuers subject to those requirements to file the

SD will require issuers to include a brief statement in the body of the form in an item entitled, "Disclosure of Payments By Resource Extraction Issuers," directing users to detailed payment information provided in an exhibit to the form. As adopted, in response to comments, the final rules require resource extraction issuers to file Form SD on EDGAR no later than 150 days after the end of the issuer's most recent fiscal year. The final rules will require resource extraction issuers to present the payment information in one exhibit to new Form SD rather than in two exhibits, as was proposed. The required exhibit must provide the information using the XBRL interactive data standard.[31] Because the XBRL exhibit will be automatically rendered into a readable form available on EDGAR, we are not requiring a separate HTML or ASCII exhibit in addition to the XBRL exhibit. Under the final rules, and as required by the statute, a resource extraction issuer must submit the payment information using electronic tags that identify, for any payments made by a resource extraction issuer to a foreign government or the U.S. Federal Government:

- the total amounts of the payments, by category;
- the currency used to make the payments;
- the financial period in which the payments were made;
- the business segment of the resource extraction issuer that made the payments;

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disclosure on Form SD. See Conflict Minerals, Release 34-67716 (August 22, 2012) ("Conflict Minerals Adopting Release"). Because of the order of our actions, we are adopting Form SD in that release and we are amending the form in this release, but we intend for the form to be used equally for these two separate disclosure requirements and potentially others that would benefit from placement in a specialized disclosure form.

31 As proposed, an issuer would have been required to submit two exhibits – one in HTML or ASCII and the other in XBRL. As discussed below, we have decided to require only one exhibit for technical reasons and to reduce the compliance burden of the final rules.

- the government that received the payments, and the country in which the government is located; and
- the project of the resource extraction issuer to which the payments relate.[32]

In addition, a resource extraction issuer must provide the type and total amount of payments made for each project and the type and total amount of payments made to each government in interactive data format. Unlike the proposal, in response to comments we received, the final rules require resource extraction issuers to file rather than furnish the payment information.

Under the final rules, a resource extraction issuer will be required to comply with the new rules and form for fiscal years ending after September 30, 2013. For the first report filed for fiscal years ending after September 30, 2013, a resource extraction issuer may provide a partial year report if the issuer's fiscal year began before September 30, 2013. The issuer will be required to provide a report for the period beginning October 1, 2013 through the end of its fiscal year. For any fiscal year beginning on or after September 30, 2013, a resource extraction issuer will be required to file a report disclosing payments for the full fiscal year.

[32] See Item 2.01(a) of Form SD (17 CFR 249.448).

B. Definition of "Resource Extraction Issuer" and Application of the Disclosure Requirements

1. Proposed Rules

In accord with Section 13(q), the proposed rules would have applied to issuers meeting the definition of "resource extraction issuer" and would have defined the term to mean an issuer that is required to file an annual report with the Commission and that engages in the commercial development of oil, natural gas, or minerals. Consistent with Section 13(q), the proposed rules would not have provided any exemptions from the disclosure requirements for resource extraction issuers. The Proposing Release further clarified that the proposed rules would apply to companies that fall within the definition of resource extraction issuer whether or not they are owned or controlled by governments.

2. Comments on the Proposed Rules

We received a variety of comments regarding the proposed rules and the application of the disclosure requirements. Numerous commentators supported the Commission's proposed definition and application of the disclosure requirements, including that the rules should not provide any exemptions from the disclosure requirements.[33] Noting an absence of

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33 See letters from Association of Forest Communities in Guatemala (March 8, 2012) ("Guatemalan Forest Communities"), Batirente (February 28, 2011), BC Investment Management Corporation (March 2, 2011) ("bcIMC"), Bon Secours Health System (March 1, 2011) ("Bon Secours"), California State Teachers' Retirement System (March 1, 2011) ("CalSTRS"), Calvert Investments (March 1, 2011) ("Calvert"), Catholic Relief Services and Committee on International Justice and Peace (February 9, 2011) ("CRS"), Derecho Ambiente y Recursos Naturales DAR (March 23, 2012) ("Derecho"), EarthRights International (December 2, 2010) (pre-proposing letter) ("ERI pre-proposal"), EarthRights International (January 26, 2011), (September 20, 2011), (February 3, 2012), (February 7, 2012) (respectively, "ERI 1," "ERI 2," "ERI 3," and "ERI 4"), Earthworks (March 2, 2011), Extractive Industries Working Group (March 2, 2011) ("EIWG"), Global Financial Integrity (March 1, 2011) ("Global Financial 2"), Global Witness (February 25, 2011) ("Global Witness 1"), Global Witness (February 24, 2012) (with attachments) ("Global Witness 2"), Global Witness (February 24, 2012) ("Global Witness 3"), Greenpeace (March 8, 2012), Grupo FARO (February 13,

statutory language regarding exemptions, several commentators stated that the legislative intent underlying Section 1504 was to provide the broadest possible coverage of extractive companies so as to create a level playing field.[34]

Most commentators that addressed the issue supported including issuers that are owned or controlled by governments within the definition of resource extraction issuer, as

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2012), Philippe Le Billon (March 2, 2012) ("Le Billon"), Libyan Transparency Association (February 22, 2012) ("Libyan Transparency"), National Civil Society Coalition on Mineral Resource Governance of Senegal (February 14, 2012) ("National Coalition of Senegal"), Newground Social Investment (March 1, 2011) ("Newground"), Nigeria Union of Petroleum and Natural Gas Workers (July 8, 2011) ("NUPENG"), ONE (March 2, 2011), ONE Petition (February 23, 2012), Oxfam America (February 21, 2011) ("Oxfam 1"), Petroleum and Natural Gas Senior Staff Association of Nigeria (June 27, 2011) ("PENGASSAN"), PGGM Investments (March 1, 2011) ("PGGM"), PricewaterhouseCoopers LLP (March 2, 2011) ("PWC"), Publish What You Pay U.S. (November 22, 2010) (pre-proposing letter) ("PWYP pre-proposal"), Publish What You Pay U.S. (February 25, 2011) ("PWYP 1"), Railpen Investments (February 25, 2011), Representative Barney Frank, Representative Jose Serrano, Representative Norman Dicks, Representative Henry Waxman, Representative Maxine Waters, Representative Donald Payne, Representative Nita Lowey, Representative Betty McCollum, Representative Barbara Lee, Representative Jesse Jackson, Jr., Representative Alcee Hastings, Representative Gregory Meeks, Representative Rosa DeLauro, and Representative Marcy Kaptur (February 15, 2012) ("Rep. Frank et al."), Revenue Watch Institute (February 17, 2011) ("RWI 1"), Peter Sanborn (March 12, 2011) ("Sanborn"), Senator Benjamin Cardin, Senator John Kerry, Senator Patrick Leahy, Senator Charles Schumer, and Representative Barney Frank (March 1, 2011) ("Sen. Cardin et al. 1"), Senator Benjamin Cardin, Senator John Kerry, Senator Patrick Leahy, Senator Carl Levin, and Senator Charles Schumer (January 31, 2012) ("Sen. Cardin et al. 2"), Senator Carl Levin (February 1, 2011) ("Sen. Levin 1"), Social Investment Forum (March 2, 2011) ("SIF"), George Soros (February 23, 2011) and (February 21, 2012) ("Soros 1" and "Soros 2", respectively), Syena Capital Management LLC (February 17, 2011) ("Syena"), Ta'ang Students and Youth Organization ("TSYO"), TIAA-CREF (March 2, 2011) ("TIAA"), US Agency for International Development (July 15, 2011) ("USAID"), United Steelworkers (March 29, 2011) ("USW"), WACAM (February 2, 2012), and World Resources Institute (March 1, 2011) ("WRI"), and letters designated as Type A and Type B. Other commentators generally voiced their support for strong rules under Section 1504. See letters from Cambodians for Resource Revenue Transparency (February 7, 2012) ("Cambodians"), Conflict Risk Network (February 7, 2012), Bill and Melinda Gates Foundation (February 9, 2012) ("Gates Foundation"), Global Witness 2, Barbara and Richard Hause (February 24, 2012), Network for the Fight Against Hunger in Cameroon (February 20, 2012) ("RELUFA 3"), Oxfam America (March 7, 2012) ("Oxfam 3"), Gradye Parsons (February 15, 2012), Representative Raul M. Grijalva (November 15, 2011), Reverend Jed Koball (February 10, 2012), and letters designated as Type C.

34 See, e.g., letters from Calvert, Global Witness 1, Oxfam 1, PWYP 1, Sen. Cardin et al. 1, Sen. Levin 1, and WRI.

proposed.[35] Commentators favored such inclusion because it would be consistent with the intent of the statute to hold all resource extraction issuers accountable for payments to governments,[36] would adhere to EITI's universality principle that payment disclosure in a given country should involve all extractive industry companies operating in that country,[37] and would avoid anti-competitive effects because many government-owned companies are the largest in the industry.[38] Another commentator stated that, while it did not believe government-owned entities should be exempt from the payment disclosure rules, it opposed requiring a government-owned entity to disclose payments made to the government that controls it. According to that commentator, such payments are not "made to further commercial development," but rather are "distributions to the entity's controlling shareholder (or to itself), and requiring them to be disclosed is inappropriate as a matter of comity."[39] Another commentator sought an exemption for payments made by a foreign government-owned company to a subsidiary or entity controlled by it.[40]

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35 See letters from American Petroleum Institute (January 28, 2011) ("API 1"), Chevron Corporation (January 28, 2011) ("Chevron"), Exxon Mobil (January 31, 2011) ("ExxonMobil 1"), Le Billon, PWYP 1, and Royal Dutch Shell plc (January 28, 2011) ("RDS 1").

36 See letter from PWYP 1.

37 See letters from API 1 and ExxonMobil 1.

38 See letters from Chevron and RDS 1.

39 See letter from Cleary Gottlieb Steen & Hamilton (March 2, 2011) ("Cleary").

40 See letter from Statoil ASA (February 22, 2011) ("Statoil").

Several other commentators supported exemptions for certain categories of issuers or for certain circumstances.[41] For example, while opposing a general exemption for smaller reporting companies, some commentators supported an exemption for a small entity having $5 million or less in assets on the last day of its most recently completed fiscal year.[42] Other commentators opposed an exemption for smaller companies because of their belief that those companies generally face greater equity risk from their operations in host countries than larger issuers.[43]

In addition, some commentators supported an exemption for circumstances in which issuers were subject to other resource extraction payment disclosure requirements, such as host country law, stock exchange listing requirements, or an EITI program.[44] Commentators believed that issuers should be able to satisfy their obligations under Section 13(q) and the related rules by providing the disclosure reported under applicable home country laws, listing

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41 See, e.g., letters from API 1, API (August 11, 2011) ("API 2") and API (May 18, 2012) ("API 5"), ExxonMobil 1, Cleary, New York State Bar Association, Securities Regulation Committee (March 1, 2011) ("NYSBA Committee"), PetroChina Company Limited (February 28, 2011) ("PetroChina"), Petroleo Brasileiro S.A. (February 21, 2011) ("Petrobras"), Rio Tinto plc (March 2, 2011) ("Rio Tinto"), RDS 1, and Statoil.

42 See letters from API 1 and ExxonMobil 1. Those commentators otherwise supported the application of the payment disclosure requirements to all classes of issuers.

43 See letters from Global Witness 1, PWYP 1, Sen. Cardin et al. 1, and Soros 1.

44 See, e.g., letters from API 1, British Petroleum p.l.c. (February 11, 2011 and July 8, 2011) (respectively "BP 1" and "BP 2"), Cleary, ExxonMobil 1, NYSBA Committee, Petrobras, Rio Tinto, RDS 1, Royal Dutch Shell (July 11, 2011) ("RDS 3"), Statoil, and Vale S.A. (March 2, 2011) ("Vale"). In addition, two commentators requested that the Commission align the rules with the reporting requirements to be adopted by the DOI for the U.S. EITI. See letters from NMA (June 15, 2012) ("NMA 3") and Northwest Mining Association (June 29, 2012) ("NWMA").

rules, or the EITI.[45] Commentators asserted that this would minimize an issuer's burden of having to comply with multiple transparency standards and avoid potentially confusing duplicative disclosure.[46] Other commentators, however, opposed providing an exemption for issuers based on other reporting requirements because such an exemption would result in an unlevel playing field and loss of comparability.[47] Some commentators asserted that because there are not currently any other national extractive disclosure regulatory regimes equivalent to Section 13(q), providing such an exemption would be premature.[48] In addition, several

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45 See, e.g., letters from API 1, ExxonMobil 1, and RDS 1 (suggesting such an approach if home country requirements are at least as rigorous as Section 13(q)); AngloGold Ashanti (January 31, 2011) ("AngloGold"), BHP Billiton Limited (July 28, 2011) ("BHP Billiton"), and Vale (suggesting such an approach if disclosure is made based on EITI principles); BP 2 and RDS 3 (supporting a global common standard for transparency disclosure and, alternatively, suggesting such an approach if disclosure is made in a broadly similar manner based on EITI principles); Cleary, NYSBA Committee, Petrobras, Rio Tinto, and Statoil (suggesting such an approach if disclosure is made pursuant to home country requirements regardless of whether those requirements follow EITI principles); and Cleary, NYSBA Committee, and Statoil (suggesting alternatively such an approach if disclosure is made based on EITI principles if the company is a participant in an EITI program).

46 See, e.g., letters from Cleary, Rio Tinto, and Statoil.

47 See, e.g., letters from ERI 1, Global Witness 1, PWYP 1, Rep. Frank et al., Sen. Cardin et al. 1, and Sen. Levin 1.

48 See, e.g., letter from PWYP 1. In this regard, after noting that the European Commission ("EC") is developing legislative proposals for extractive industry reporting rules in the European Union ("EU"), one commentator stated that "it is critical that country-by-country and project-by-project disclosure regulations are adopted across other major markets to ensure a level playing field and consistent reporting across countries." Letter from Publish What You Pay U.K. (April 28, 2011) ("PWYP U.K."). The EC subsequently published proposals for extractive industry payment disclosure requirements. See discussion in note 82. After the EC published the proposals, PWYP urged the Commission to take the initiative and promptly adopt final rules so that the EC can harmonize its extractive disclosure requirements with the Section 13(q) rules. See letter from Publish What You Pay (December 19, 2011) ("PWYP 2"). The EC proposals are currently pending.

commentators maintained that Section 13(q) was intended to go beyond the disclosure provided under the EITI.[49]

Many commentators supported an exemption from the disclosure requirements when the required payment disclosure is prohibited under the host country's laws.[50] Some commentators stated that the laws of China, Cameroon, Qatar, and Angola would prohibit disclosure required under Section 13(q) and expressed concern that other countries would enact similar laws.[51] Commentators stated that without an appropriate exemption, Section 13(q) would become a "business prohibition" statute that would force issuers to choose between leaving their operations in certain countries or breaching local law and incurring penalties in order to comply with the statute's requirements.[52] Either outcome, according to

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49 See letters from Global Witness 1, PWYP 1, and Sen. Benjamin Cardin (December 1, 2010) (pre-proposal letter) ("Cardin pre-proposal").

50 See letters from API 1, API 2, API 5, AngloGold Ashanti (January 31, 2011) ("AngloGold"), Spencer Bachus, Chairman of the U.S. House of Representatives Committee on Financial Services, and Gary Miller, Chairman of the U.S. House of Representatives Subcommittee on International Monetary Policy, Committee on Financial Services (March 4, 2011) ("Chairman Bachus and Chairman Miller"), Barrick Gold Corporation (February 28, 2011) ("Barrick Gold"), BP 1, Chamber of Commerce Institute for 21st Century Energy (March 2, 2011) ("Chamber Energy Institute"), Chevron, Cleary, ExxonMobil 1, ExxonMobil (March 15, 2011) ("ExxonMobil 2"), International Association of Oil and Gas Producers (January 27, 2011) ("IAOGP"), NMA 2, NYSBA Committee, Nexen Inc. (March 2, 2011) ("Nexen"), PetroChina, Petrobras, PWC, Rio Tinto, RDS 1, Royal Dutch Shell (May 17, 2011) ("RDS 2"), Royal Dutch Shell (August 1, 2011) ("RDS 4"), Senator Lisa Murkowski and Senator John Cornyn (February 28, 2012) ("Sen. Murkowski and Sen. Cornyn"), Split Rock International, Inc. (March 1, 2011) ("Split Rock"), Statoil, Talisman Energy Inc. ("Talisman") (June 23, 2011), and Vale. See also letter from Cravath, Swaine & Moore LLP, Cleary Gottlieb Steen & Hamilton LLP, Davis Polk & Wardwell LLP, Shearman & Sterling LLP, Simpson Thacher & Bartlett LLP, Skadden, Arps, Slate, Meagher & Flom LLP, Sullivan & Cromwell LLP, and Wilmer Cutler Pickering Hale and Dorr LLP (November 5, 2010) (pre-proposal letter) ("Cravath et al. pre-proposal").

51 See letters from API 1 and ExxonMobil 1. See also letter from RDS 1 (mentioning China, Cameroon, and Qatar).

52 See letters from Barrick Gold, Cleary, NYSBA Committee, Rio Tinto, and Statoil; see also letter from API 5.

commentators, would adversely affect investors, efficiency, competition, and capital formation.[53] Some commentators further suggested that failure to adopt such an exemption could encourage foreign issuers to deregister from the U.S. market.[54] Other commentators maintained that comity concerns must be considered when the Section 13(q) disclosure requirements conflict with foreign law.[55] One commentator suggested that an exemption would be consistent with Executive Order 13609, which directs federal agencies to take certain steps to "reduce, eliminate, or prevent unnecessary differences in [international] regulatory requirements."[56]

Other commentators opposed an exemption for host country laws prohibiting disclosure of payment information because they believed it would undermine the purpose of Section 13(q) and create an incentive for foreign countries that want to prevent transparency to pass such laws, thereby creating a loophole for companies to avoid disclosure.[57]

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53 See, e.g., letters from API 1, ExxonMobil 1, and RDS 1; see also letter from API 5. Several commentators noted that the Commission has a statutory duty to consider efficiency, competition, and capital formation when adopting rules. See letter from American Petroleum Institute (January 19, 2012) ("API 3"), Cravath et al. pre-proposal, Senator Mary L. Landrieu (March 6, 2012), and Sen. Murkowski and Sen. Cornyn.

54 See letters from Cleary, Royal Dutch Shell (October 25, 2010) (pre-proposal letter) ("RDS pre-proposal"), Split Rock, and Statoil. See also letter from Branden Carl Berns (December 7, 2011) ("Berns") (maintaining that some foreign issuers subject to Section 13(q) with modest capitalizations on U.S. exchanges might choose to delist in response to competitive advantages enjoyed by issuers not subject to Section 13(q)).

55 See letters from API 5 and NMA 2.

56 See letter from API 5. We note that the responsibilities of federal agencies under Executive Order 13609 are to be carried out "[t]o the extent permitted by law" and that foreign regulatory approaches are to be considered "to the extent feasible, appropriate, and consistent with law." See Proclamation No. 13609, 77 Fed. Reg. 26413 (May 4, 2012).

57 See, e.g., letters from Cambodians, EG Justice (February 7, 2012) ("EG Justice 2"), Global Witness 1, Grupo Faro, Human Rights Foundation of Monland (March 8, 2011 and July 15, 2011) (respectively,

Commentators also disputed the assertion that there are foreign laws that specifically prohibit disclosure of payment information.[58] Those commentators noted that most confidentiality laws in the extractive industry sector relate to the confidentiality of geological and other technical data, and in any event, contain specific provisions that allow for disclosures to stock exchanges.[59]

Many commentators also sought an exemption from the disclosure requirements for payments made under existing contracts that contain confidentiality clauses prohibiting such disclosure.[60] According to commentators, while some contracts may permit the disclosure of information to comply with an issuer's home country laws, regulations, or stock exchange rules, those contractual provisions only allow the contracting party, not its parent or affiliate companies, to make the disclosure.[61] Some commentators also sought an exemption from the requirements for payments made under future contracts containing confidentiality clauses.[62]

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"HURFOM 1" and "HURFOM 2"), National Coalition of Senegal, PWYP 1, Rep. Frank et al., Sen. Cardin et al. 1, Sen. Cardin et al. 2, Sen. Levin 1, Soros 2, U.S. Agency for International Development (July 15, 2011) ("USAID"), and WACAM.

58 See, e.g., letters from ERI 3, Global Witness 1, PWYP 1, Publish What You Pay (December 20, 2011) ("PWYP 3"), and Rep. Frank et al.

59 See letters from Global Witness 1, Susan Maples, J.D., Post-Doctoral Research Fellow, Columbia University School of Law (March 2, 2011) ("Maples"), Network for the Fight Against Hunger in Cameroon (March 14, 2011 and July 11, 2011) (respectively, "RELUFA 1" and "RELUFA 2"), and PWYP 1.

60 See letters from API 1, AngloGold, Barrick Gold, Chairman Bachus and Chairman Miller, BP 1, Chamber Energy Institute, Chevron, Cleary, ExxonMobil 1, IAOGP, NMA 2, NYSBA Committee, Nexen, PetroChina, Petrobras, PWC, Rio Tinto, RDS 1, Split Rock, Statoil, and Vale.

61 See letters from API 1 and ExxonMobil 1.

62 See letters from AngloGold and NMA 2. AngloGold suggested conditioning the exemption on an issuer having made a good faith determination that it would not have been able to enter into the contract but for agreeing to a confidentiality provision.

Other commentators opposed an exemption based on confidentiality clauses in contracts on the grounds that such an exemption was not necessary.[63] Commentators maintained that most contracts include an explicit exception for information that must be disclosed by law, and, in cases where such language is not explicit, it generally would be read into any such contract under judicial or arbitral review.[64] Commentators further stated that an exemption based on contract confidentiality would undermine Section 13(q) by creating incentives for issuers to craft such contractual provisions.[65]

Several commentators supported an exemption for situations when, regardless of the existence of a contractual confidentiality clause, such disclosure would jeopardize commercially or competitively sensitive information.[66] Other commentators expressed doubt that disclosure of payment information would create competitive disadvantages because much of the information is already available from third-party service providers or through the large number of joint ventures between competitors in the extractive industries.[67]

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63 See letters from Global Witness 1, Maples, Oxfam (March 20, 2012) ("Oxfam 3"), and PWYP 1.

64 See, e.g., letters from Oxfam 3 and PWYP 1. See also letter from SIF citing the "official Production Sharing Contract of the government of Equatorial Guinea" and noting that it explicitly states that companies are permitted to share all information relating to the Contract or Petroleum Operations in the following instances: "to the extent that such data and information is required to be furnished in compliance with any applicable laws or regulation" (Article 20.1.1c) and "[i]n conformity with the requirements of any stock exchange having jurisdiction over a Party[.]" (Article 20.1.1d)).

65 See, e.g., letters from Global Witness 1 and Oxfam 1.

66 See letters from American Exploration and Production Council (January 31, 2011) ("AXPC"), API 1, Chamber Energy Institute, Chevron, ExxonMobil 1, IAOGP, Local Authority Pension Fund Forum (January 31, 2011) ("LAPFF"), NMA 2, Rio Tinto, RDS 1, and United States Council for International Business (February 4, 2011) ("USCIB").

67 See letters from PWYP 1 and RWI 1; see also letter from Global Witness 1(noting a study finding that the majority of disclosures that would be required pursuant to Section 13(q) would already be known to actors within the industry).

Commentators also expressed concern that providing an exemption for commercially or competitively sensitive information would frustrate Congress' intent to achieve payment transparency and accountability.[68]

Some commentators believed that the disclosure of detailed payment information would jeopardize the safety and security of a resource extraction issuer's operations or employees and requested an exemption in such circumstances.[69] Other commentators believed that detailed payment disclosure was critical for workers and their communities to achieve benefits from investment transparency, including a decrease in unrest and conflict and increased stability and safety.[70]

Some commentators requested that the Commission extend the disclosure requirements to foreign private issuers that are exempt from Exchange Act reporting obligations but publish their annual reports and other material home country documents electronically in English pursuant to Exchange Act Rule 12g3-2(b).[71] Those commentators

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68 See, e.g., letter from Global Witness 1. Another commentator stated that "to the extent that Section 13(q)'s reporting obligations result in some competitive disadvantage to regulated issuers, Congress already accepted this risk when it determined that pursuing the goals of promoting transparency and good governance was of paramount importance—even at the cost of an incidental burden on issuers. . . As with the Foreign Corrupt Practices Act, Congress made the affirmative choice to set a higher standard for global corporate practice. Other countries have already started to follow Congress' lead in this area. . .Strong U.S. leadership with respect to transparency in the extractive industries will make it easier for foreign governments to adopt similar reporting requirements, which in turn will serve to level the playing field." Letter from Oxfam 1.

69 See letters from API 1, Spencer Bachus, Chairman of the U.S. House of Representatives Committee on Financial Services (August 21, 2012) ("Chairman Bachus"), Chevron, ExxonMobil 1, NMA 2, Nexen, PetroChina, and RDS 1.

70 See letters from NUPENG, PENGASSAN, PWYP 1, and USW.

71 See letters from API 1, Calvert, ExxonMobil 1, Global Witness 1, RWI 1, and RDS 1.

asserted that requiring such issuers to comply with the disclosure requirements would help ameliorate anti-competitive concerns. Other commentators, however, opposed extending the disclosure required under Section 13(q) to companies that are exempt from Exchange Act registration and reporting because it would discourage use of the Rule 12g3-2(b) mechanism[72] and because such an extension would be inconsistent with the premise of Rule 12g3-2(b).[73]

### 3. Final Rules

Consistent with the proposal, we are adopting final rules that define the term "resource extraction issuer" as it is defined in Section 13(q). The final rules will apply to all U.S. companies and foreign companies that are engaged in the commercial development of oil, natural gas, or minerals and that are required to file annual reports with the Commission, regardless of the size of the company or the extent of business operations constituting commercial development of oil, natural gas, or minerals.[74] Consistent with the proposal, the final rules will apply to a company, whether government-owned or not, that meets the definition of resource extraction issuer.[75] Any failure to include government-owned companies within the scope of the disclosure rules could raise competitiveness concerns.[76]

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72 See letter from NYSBA Committee.

73 See letter from NMA 2 and NYSBA Committee.

74 See new Exchange Act Rule 13q-1.

75 As discussed below, a resource extraction issuer, including a government-owned resource extraction issuer, will be required to provide the payment disclosure if the other requirements of the rule are met. Contrary to some commentators' suggestions, we are not providing a carve-out from the rules for payments made by a government-owned resource extraction issuer to its controlling government because we believe it would be inconsistent with the purpose of the statute. We note a government-owned resource extraction issuer would only disclose payments made to the government that controls

Although some commentators urged us to provide exemptions for certain categories of issuers,[77] in light of the statutory purpose of Section 13(q),[78] we have decided not to adopt exemptions from the disclosure requirement for any category of resource extraction issuers, including smaller issuers and foreign private issuers. We believe the transparency objectives of Section 13(q) are best served by requiring disclosure from all resource extraction issuers. In addition, we agree with commentators that providing an exemption for smaller reporting companies or foreign private issuers could contribute to an unlevel playing field and raise competitiveness concerns for larger companies and domestic companies.[79] We also note that some commentators opposed an exemption for smaller companies because of their belief that those companies generally face greater equity risk from their operations in host countries than larger issuers.[80]

The final rules also do not permit resource extraction issuers to satisfy the disclosure requirements adopted under Section 13(q) by providing disclosures required under other extractive transparency reporting requirements, such as under home country laws, listing rules, or an EITI program. Section 13(q) does not provide such an accommodation and, as

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it if those payments were made for the purpose of commercial development of oil, natural gas, or minerals and the payments are within the categories of payments that would be required to be disclosed under the rules.

76 See note 38 and accompanying text.

77 See note 41 and accompanying text.

78 See note 7 and accompanying text.

79 See notes 33 and 34 and accompanying text.

80 See letters from Global Witness 1, PWYP 1, Sen. Cardin et al. 1, and Soros 1.

noted by some commentators, in some respects the statute extends beyond the disclosure required under other transparency initiatives.[81] In addition, we note that transparency initiatives for resource extraction payment disclosure are continuing to develop.[82] Therefore, we believe it would be premature to permit issuers to satisfy their disclosure obligation by complying with other extractive transparency reporting regimes or by providing the disclosure required by those regimes in lieu of the disclosure required by the rules we are adopting under Section 13(q).[83]

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81 See note 49 and accompanying text.

82 One recent development is the European Commission's issuance in October 2011 of proposed directives that would require companies listed on EU stock exchanges and large private companies based in EU member states to disclose their payments to governments for oil, gas, minerals, and timber. See the European Commission's press release concerning the proposal, which is available at: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/1238&format=HTML&aged=0&language=EN&guiLanguage=en. The EU proposal differs from the final rules we are adopting in several respects. For example, the EU proposal would apply to large, private EU-based companies as well as EU-listed companies engaged in oil, natural gas, minerals, and timber, whereas the final rules apply only to Exchange Act reporting companies engaged in oil, natural gas, and mining. The EU proposal would require disclosure of payments that are material to the recipient government, whereas the final rules require disclosure of payments that are not de minimis. Further, the EU proposal would apply to exploration, discovery, development, and extraction activities, whereas the final rules apply to exploration, extraction, processing, and export activities. In addition, while both the EU proposal and final rules require payment disclosure per project and government, the EU proposal would base project reporting on a company's current reporting structure whereas, as discussed below, the final rules leave the term "project" undefined. See also letter from PWYP 2. Other jurisdictions have introduced, but have not adopted, transparency initiatives. See letter from ERI 4 and note 14 and accompanying text.

83 In this regard, we are not persuaded by comments suggesting that we should align our rules with any reporting requirements that may be adopted by the DOI as part of U.S. EITI. DOI is continuing its efforts to develop a U.S. EITI program and is currently working to form the stakeholder group. In addition, the scope of EITI programs generally differs from the scope of the requirements of Section 13(q). An EITI program adopted by a particular country generally requires disclosure of payments to that country's governments by companies operating in that country, but does not require disclosure of payments made by those companies to foreign governments. The disclosure requirements are developed country by country. In contrast, Section 13(q) requires disclosure of payments to the federal and foreign governments by resource extraction issuers. As noted elsewhere in this release, the requirements of the statute differ from the EITI in a number of respects.

Consistent with Section 13(q) and the proposed rules, we also are not providing an exemption for any situations in which foreign law may prohibit the required disclosure. Although some commentators asserted that certain foreign laws currently in place would prohibit the disclosure required under Section 13(q), other commentators disagreed and asserted that currently no foreign law prohibits the disclosure.[84] Further, as noted above, some commentators believed that we should adopt final rules providing an exemption from the disclosure requirements where foreign laws prohibit the required disclosure, including laws that may be adopted in the future,[85] while others believed that providing such an exemption would be inconsistent with the statute and would encourage countries to adopt laws specifically prohibiting the required disclosure.[86] While we understand commentators'

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84 Compare letters from API 1, Barrick Gold, Cleary, ExxonMobil 1, NMA 2, NYSBA Committee, Rio Tinto, RDS 1, and Statoil with letters from EarthRights International (February 3, 2012) ("ERI 3"), Global Witness, PWYP, Publish What You Pay (December 20, 2011) ("PWYP 2"), Maples, and Rep. Frank et al. Several of the comment letters from issuers and industry associations assert that existing laws in Angola, Cameroon, China, and Qatar prohibit, or in some situations may prohibit, disclosure of the type required by Section 13(q). One commentator submitted translations of Despacho 385/06, issued by the Minister of the Angola Ministry of Petroleum, as amended by Despacho 409/06 (the "Angola Order") and a letter dated December 23, 2009, from the Deputy Premier, Minister of Energy & Industry, of the State of Qatar (the "Qatar Directive"). See letter from ExxonMobil 2. Another commentator submitted a translation of certain sections of Decree No. 2000/465 relating to the Cameroon Petroleum Code, a copy of a legal opinion from Cameroon counsel, and a copy of a legal opinion from Chinese counsel. See letter from RDS 1. We are not aware of any other examples submitted on the public record of foreign laws purported to prohibit disclosure of payments by resource extraction issuers. Other commentators have submitted contrary data, arguing that the laws of Angola, Cameroon, China, and Qatar do not prohibit a resource extraction issuer from complying with Section 13(q) and the final rules, and providing examples of companies that have disclosed payment information relating to resource development activities in Angola, Cameroon, and China. See letter from ERI 3. One commentator submitted a legal opinion stating that "[n]othing in Cameroonian law prevents oil companies from publishing data on revenues they pay to the state derived from oil contracts signed with the government."

85 See, e.g., API 1, ExxonMobil 1, and RDS 1.

86 See, e.g., letters from Cambodians, EG Justice (February 7, 2012) ("EG Justice 2"), Global Witness 1, Grupo Faro, HURFOM 1 and HURFOM 2, National Coalition of Senegal, PWYP, Rep. Frank et al.,

concerns regarding the situation an issuer may face if a country in which it does business or would like to do business prohibits the disclosure required under Section 13(q),[87] the final rules we are adopting do not include an exemption for situations in which foreign law prohibits the disclosure. We believe that adopting such an exemption would be inconsistent with the structure and language of Section 13(q)[88] and, as some commentators have noted,[89] could undermine the statute by encouraging countries to adopt laws, or interpret existing laws, specifically prohibiting the disclosure required under the final rules.

Consistent with Section 13(q) and the proposed rules, the final rules do not provide an exemption for instances when an issuer has a confidentiality provision in a relevant contract, as requested by some commentators.[90] We understand that contracts typically allow for

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Sen. Cardin et al., Sen. Cardin et al. 2, Sen. Levin 1, Soros 2, US Agency for International Development (July 15, 2011) ("USAID"), and WACAM.

87 See, e.g., API 1, ExxonMobil 1, and RDS 1.

88 As noted by some commentators, Section 23(a)(2) requires us, when adopting rules, to consider the impact any new rule would have on competition. See, e.g., letters from API 1, API 3, Chairman Bachus, Cravath et al pre-proposal, and ExxonMobil 1. Specifically, Section 23(a)(2) requires us "to consider...the impact any such rule or regulation would have on competition" in making rules pursuant to the Exchange Act. Further, the section states that the Commission "shall not adopt any such rule...which would impose a burden on competition not necessary or appropriate in furtherance of [the Exchange Act]." As discussed further below, we recognize the final rules may impose a burden on competition; however, in light of the language and purpose of Section 13(q), which is now part of the Exchange Act, we believe the rules we are adopting pursuant to the provision and any burden on competition that may result are necessary in furtherance of the purpose of the Exchange Act, including Section 13(q) of the Exchange Act.

89 See, e.g., letters from Cambodians, EG Justice (February 7, 2012) ("EG Justice 2"), Global Witness 1, Grupo Faro, HURFOM 1 and HURFOM 2, National Coalition of Senegal, PWYP, Rep. Frank et al., Sen. Cardin et al., Sen. Cardin et al. 2, Sen. Levin 1, Soros 2, USAID, and WACAM.

90 See, e.g., letters from API 1, Chevron, Cleary, ExxonMobil 1, NMA 2, and RDS 1.

disclosure to be made when required by law for reporting purposes.[91] Although some commentators maintained that those types of contractual provisions only allow the contracting party, not its parent or affiliate companies, to make the disclosure,[92] the final rules we are adopting do not include an exemption for confidentiality provisions in contracts because we believe this issue can be more appropriately addressed through the contract negotiation process.[93] As noted by some commentators, a different approach might encourage a change in practice or an increase in the use of confidentiality provisions to circumvent the disclosure required by the final rules.[94] In addition, including an exemption from the disclosure requirements for payments made under existing contracts that contain confidentiality clauses prohibiting such disclosure, as suggested by some commentators,[95] would frustrate the purpose of Section 13(q).

Although some commentators sought an exemption for commercially or competitively sensitive information, regardless of the existence of a confidentiality provision in a contract,[96] the final rules do not provide such an exemption. We note that commentators disagreed on the need for an exemption for commercially or competitively sensitive

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91 See letters from Global Witness 1, Maples, and PWYP 1.

92 See letters from API 1 and ExxonMobil 1.

93 See letter from Maples.

94 See letters from Global Witness and Oxfam.

95 See note 60 and accompanying text.

96 See note 66 and accompanying text.

information.[97] While we understand commentators' concerns about potentially being required to provide commercially or competitively sensitive information,[98] we also are cognizant of other commentators' concerns that such an exemption would frustrate the purpose of Section 13(q) to promote international transparency efforts.[99] We note that in situations involving more than one payment, the information will be aggregated by payment type, government, and/or project, and therefore may limit the ability of competitors to use the information to their advantage.

We note that some commentators sought an exemption for circumstances in which a company believes that disclosure might jeopardize the safety and security of its employees and operations,[100] while other commentators opposed such an exemption and noted their belief that increased transparency would instead increase safety for employees.[101] We understand issuers' concerns about the safety of their employees and operations; however, in light of commentators' disagreement on this issue, including the belief by some commentators that disclosure will improve employee safety, and the fact that the statute seeks to promote international transparency efforts, we are not persuaded that such an exemption is warranted and we are not including it in the final rules. We also note that

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97 See notes 66 and 67 and accompanying text.

98 See note 66 and accompanying text.

99 See note 68 and accompanying text.

100 See note 69 and accompanying text.

101 See note 70 and accompanying text.

neither the statute nor the final rules require disclosure regarding the names or location of employees.

The final rules do not extend the disclosure requirements to foreign private issuers that are exempt from Exchange Act registration pursuant to Rule 12g3-2(b). Foreign private issuers relying on Rule 12g3-2(b) are not required to file annual reports with the Commission and thus, they do not fall within the plain definition of resource extraction issuer provided in the statute. In addition, we believe that such an extension would be inconsistent with the premise of Rule 12g3-2(b).[102] Issuers that are exempt from Exchange Act registration pursuant to Rule 12g3-2(b) are not subject to reporting requirements under the Exchange Act, including any requirement to file an annual report.

### C. Definition of "Commercial Development of Oil, Natural Gas, or Minerals"

#### 1. Proposed Rules

Consistent with Section 13(q), the proposed rules defined "commercial development of oil, natural gas, or minerals" to include the activities of exploration, extraction, processing, export and other significant actions relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity. In proposing the definition, we intended to capture only activities that are directly related to the commercial development of oil, natural gas, or minerals, but not activities that are ancillary or preparatory, such as the manufacture of a product used in the commercial development of oil, natural gas, or minerals. In the Proposing Release, we noted that commercial development would not include transportation

[102] See note 73 and accompanying text.

activities for a purpose other than export. In addition, we noted, as an example, that an issuer engaged in the removal of impurities, such as sulfur, carbon dioxide, and water, from natural gas after extraction but prior to its transport through the pipeline would be included in the definition of commercial development because such removal is generally considered to be a necessary part of the processing of natural gas in order to prevent corrosion of the pipeline.

### 2. Comments on the Proposed Rules

Commentators supported various aspects of the proposed definition[103] while suggesting clarifications or alternative approaches to the definition of commercial development. For example, numerous commentators suggested defining commercial development to include upstream activities (exploration and extraction of resources) only.[104] Commentators noted that Section 13(q) is entitled "Disclosure of Payments by Resource Extraction Issuers," and as such, the statute "is directed toward those issuers who are engaged in extractive activities, or what are commonly referred to as 'upstream activities.'"[105] Commentators also noted that the EITI focuses on upstream activities[106] and that the statute directs the Commission "to consider consistency with EITI guidelines in the rules it develops."[107] Several commentators noted they believed defining commercial

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103 See, e.g., letters from API 1, AngloGold, BP 1, CRS, Global Financial Integrity 2, NMA 2, and PWYP 1.

104 See letters from API 1, AXPC, Barrick Gold, BP 1, Chevron, ExxonMobil 1, NMA 2, Petrobras, PWC, RDS 1, and Statoil.

105 See letters from API 1 and ExxonMobil 1.

106 See, e.g., letters from API 1 and NMA 2.

107 See letters from API 1 and ExxonMobil 1.

development to include only upstream activities would be consistent with the Commission's existing definition of "oil and gas producing activities" in Regulation S-X Rule 4-10.[108] In addition, commentators noted that adopting a definition of commercial development that is based on the definition of "oil and gas producing activities" in Regulation S-X would align it with a widely understood and accepted industry definition.[109] According to commentators

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108 See, e.g., letters from API 1, Chevron, ExxonMobil 1, and RDS 1. Rule 4-10(a)(16) defines "oil and gas producing activities" to include:

(A) The search for crude oil, including condensate and natural gas liquids, or natural gas ("oil and gas") in their natural states and original locations;

(B) The acquisition of property rights or properties for the purpose of further exploration or for the purpose of removing the oil or gas from such properties;

(C) The construction, drilling, and production activities necessary to retrieve oil and gas from their natural reservoirs, including the acquisition, construction, installation, and maintenance of field gathering and storage systems, such as:

(1) Lifting the oil and gas to the surface; and

(2) Gathering, treating, and field processing (as in the case of processing gas to extract liquid hydrocarbons); and

(D) Extraction of saleable hydrocarbons, in the solid, liquid, or gaseous state, from oil sands, shale, coalbeds, or other nonrenewable natural resources which are intended to be upgraded into synthetic oil or gas, and activities undertaken with a view to such extraction.

(ii) Oil and gas producing activities do not include:

(A) Transporting, refining, or marketing oil and gas;

(B) Processing of produced oil, gas or natural resources that can be upgraded into synthetic oil or gas by a registrant that does not have the legal right to produce or a revenue interest in such production;

(C) Activities relating to the production of natural resources other than oil, gas, or natural resources from which synthetic oil and gas can be extracted; or

(D) Production of geothermal steam. (Instructions omitted.)

109 See letters from API 1 and ExxonMobil 1.

advocating this approach, "commercial development of oil, natural gas, or minerals" would include "exploration, extraction, field processing and gathering/transportation activities to the first marketable location."[110] Some commentators suggested clarifying, either in the regulatory text or in the adopting release, that the definition would include field processing activities prior to the refining or smelting phase, such as upgrading of bitumen and heavy oil and crushing and processing of raw ore, as well as transport activities related to the export of oil, natural gas, or minerals to the first marketable location.[111] In focusing exclusively on mining activities, one commentator stated that the definition of "commercial development" should include exploration, extraction, and production, and activities of processing and export to the extent that they are associated with production.[112] Under that approach, the definition would include steps in production prior to the smelting or refining phase, such as crushing of raw ore, processing of the crushed ore, and export of processed ore to the smelter, but would not include the actual smelting or refining. Several commentators stated that the definition should exclude transportation and other midstream or downstream activities, including export.[113] According to some of those commentators, "'export' activities are not always directly associated with oil and gas producing activities, and can often be

110 See, e.g., letter from API 1.

111 See letters from AXPC, API 1, Barrick Gold, BP 1, Chevron, ExxonMobil 1, NMA 2, Petrobras, PWC, RDS 1, and Statoil.

112 See letter from NMA 2.

113 See letters from API 1, Barrick Gold, ExxonMobil 1, National Fuel Gas Supply Corporation (March 1, 2011) ("National Fuel"), and NMA 2.

undertaken by issuers that are not engaged in 'resource extraction' at all."[114] They believed that requiring the reporting of payments by such issuers goes beyond the intended scope of the statute. One commentator urged us to state explicitly that "commercial development" does not include transportation activities and that transportation activities include the underground storage of natural gas.[115] Another commentator stated that an issuer should be allowed to choose whether to include transportation in the definition of "commercial development" as long as it discloses the basis for its definition.[116]

Other commentators stated that, at a minimum, the definition of "commercial development" must include the activities of exploration, extraction, processing, and export.[117] One commentator argued that, although the EITI does not include processing and export activities in its minimum disclosure requirements, the definition of "commercial development" must include those activities to be consistent with the plain language of Section 13(q) and because Congress intended the statute to go beyond the EITI's requirements.[118] Another commentator suggested expanding the proposed definition to include not just upstream activities, but also midstream activities (activities involved in trading and transport of resources), and downstream activities (activities involved in refining,

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114 See letter from API 1. See also letter from ExxonMobil 1.

115 See letter from National Fuel.

116 See letter from Rio Tinto.

117 See letters from CRS and PWYP 1.

118 See letter from PWYP 1.

ore processing, and marketing of resources).[119] The commentator agreed with the proposal that the definition should not include activities of a manufacturer of a product used in the commercial development of oil, natural gas, or minerals.

Some commentators requested further clarification that covered transport activities include not just those related to export, but those related to the processing or marketing of resources, whether intra-country or cross-border, and whether by pipeline, rail, road, air, ship, or other means.[120] Two commentators requested that the Commission define "transportation activities" to include pipelines and security arrangements associated with a pipeline within a host country.[121]

Some commentators agreed with the proposal that "commercial development" should exclude activities that are ancillary or preparatory to commercial development.[122] One commentator suggested that the term focus on activities that "directly relate to, and provide material support for, the physical process of extracting and processing ore and producing minerals from that ore, including the export of ore to the smelter."[123] The commentator further noted that activities that "do not directly and materially further this process, such as development of infrastructure and the community, as well as security support, generally

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119 See letter from Calvert.

120 See letters from Calvert, CRS, Earthworks, EIWG, HURFOM 1, PWYP pre-proposal, PWYP 1, and WRI.

121 See letters from PWYP 1 and Syena; see also letter from Le Billon (suggesting coverage of transportation in general, security services, and trading).

122 See letters from NMA 2 and Statoil.

123 Letter from NMA 2.

would fall outside this definition, unless they include payments to governments that are expressly required by concession, contract, law, or regulation."[124] Another commentator requested that we provide further detail about the extractive activities to which the rules would apply.[125]

### 3. Final Rules

Consistent with Section 13(q) and the proposal, the final rules define "commercial development of oil, natural gas, or minerals" to include the activities of exploration, extraction, processing, and export, or the acquisition of a license for any such activity. As we noted in the Proposing Release, the statutory language sets forth a clear list of activities in the definition and gives us discretionary authority to include other significant activities relating to oil, natural gas, or minerals under the definition of "commercial development." As described above, the final rules we are adopting generally track the language in the statute, and except for where the language or approach of Section 13(q) clearly deviates from the EITI, the final rules are consistent with the EITI. In instances where the language or approach of Section 13(q) clearly deviates from the EITI, the final rules track the statute rather than the EITI. The definition of "commercial development" in Section 13(q) is broader than the activities covered by the EITI and thus clearly deviates from the EITI; therefore, we believe the definition of the term in the final rules should be consistent with Section 13(q).

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124 Letter from NMA 2.

125 See letter from Syena.

As noted above, we received significant comment on this aspect of the proposal. Some commentators sought a more narrow definition than proposed, while other commentators sought a broader definition. We are not persuaded that we should narrow the scope of the definition in Section 13(q) by re-defining "commercial development" to only include upstream activities[126] or using the definition of "oil and gas producing activities" in Rule 4-10.[127] Nor are we persuaded that we should expand the covered activities[128] beyond those identified in the statute.[129] Under the final rules, the definition of commercial development includes all of the activities specified in the statutory definition, even though the statute includes activities beyond what is currently contemplated by the EITI.[130]

Section 13(q) grants us the discretionary authority to include other significant activities relating to oil, natural gas, or minerals under the definition of "commercial development."[131] In deciding whether to expand the statutory list of covered activities, we have considered both commentators' views and the need to promote consistency with EITI

126 See note 104 and accompanying text.

127 See note 108 and accompanying text.

128 See note 119 and accompanying text.

129 We believe the phrase "as determined by the Commission" at the end of the definition of "commercial development" in Section 13(q) requires the Commission to identify any "other significant actions" that would be covered by the rules. See 15 U.S.C. 78m(q)(1)(A). As noted above, we are not expanding the list of activities covered by the definition of "commercial development." Therefore, to avoid confusion as to the scope of the activities covered by the rules, the final rules do not include the phrase "and other significant actions relating to oil, natural gas, or minerals."

130 In the Proposing Release, we noted our understanding that the EITI criteria primarily focus on exploration and production activities. See, e.g., Implementing the EITI, at 24. We note that although export payments are not typically included under the EITI, some EITI programs have reported export taxes or related duties. See the 2005 EITI Report of Guinea, the 2008-2009 EITI Report of Liberia, and the 2006-2007 EITI Report of Sierra Leone, available at http://eiti.org/document/eitireports.

131 See 15 U.S.C. 78m(q)(1)(A).

principles. We are not persuaded that we should extend the rules to activities beyond the statutory list of activities comprising "commercial development" because we are mindful of imposing additional costs resulting from adopting rules that extend beyond Congress' clear directive.

As noted in the Proposing Release, the definition of "commercial development" is intended to capture only activities that are directly related to the commercial development of oil, natural gas, or minerals. It is not intended to capture activities that are ancillary or preparatory to such commercial development. Accordingly, we would not consider a manufacturer of a product used in the commercial development of oil, natural gas, or minerals to be engaged in the commercial development of the resource. For example, in contrast to the process of extraction, manufacturing drill bits or other machinery used in the extraction of oil would not fall within the definition of commercial development.

In response to commentators' requests for clarification of the activities covered by the final rules, we also are providing examples of activities covered by the terms "extraction," "processing," and "export." We note, however, that whether an issuer is a resource extraction issuer will depend on its specific facts and circumstances.

As we noted in the Proposing Release, "extraction" includes the production of oil and natural gas as well as the extraction of minerals. Under the final rules, "processing" includes field processing activities, such as the processing of gas to extract liquid hydrocarbons, the removal of impurities from natural gas after extraction and prior to its transport through the pipeline, and the upgrading of bitumen and heavy oil. Processing also includes the crushing and processing of raw ore prior to the smelting phase. We do not believe that "processing" was intended to include refining or smelting,[132] and we note that refining and smelting are not specifically listed in Section 13(q). In addition, as some commentators noted, including refining or smelting within the final rules under Section 13(q) would go beyond what is currently contemplated by the EITI, which does not include refining and smelting activities.[133]

We believe that "export" includes the export of oil, natural gas, or minerals from the host country. We disagree with those commentators who maintained that "export" means the removal of the resource from the place of extraction to the refinery, smelter, or first marketable location.[134] Adopting such a definition would be contrary to the plain meaning of export,[135] and nothing in Section 13(q) or the legislative history suggests that Congress meant

132 The Commission's oil and gas disclosure rules identify refining and processing separately in the definition of "oil and gas producing activities," which excludes refining and processing (other than field processing of gas to extract liquid hydrocarbons by the company and the upgrading of natural resources extracted by the company other than oil or gas into synthetic oil or gas). See Rule 4-10(a)(16)(ii) of Regulation S-X [17 CFR 210.4-10(a)(16)(ii)] and note 108. In addition, we note that in another statute adopted by Congress, the Sudan Accountability and Divestment Act of 2007 (SADA), relating to resource extraction activities, the statute specifically identifies "processing" and "refining" separately in defining "mineral extraction activities" and "oil-related activities." 110 P.L. No. 174 (2007). Specifically, Section 2(7) of SADA defines "mineral extraction activities" to mean "exploring, extracting, processing, transporting, or wholesale selling of elemental minerals or associated metal alloys or oxides (ore)…." Section 2(8) of SADA defines "oil-related activities" to mean in part "exporting, extracting, producing, refining, processing, exploring for, transporting, selling, or trading oil…." The inclusion of "processing" and "refining" in SADA, in contrast to the language of Section 13(q), suggests that the terms have different meanings. Absent designation by the Commission, we do not believe that "refining" was intended to be included in the scope of the express terms in Section 13(q).

133 See, e.g., letters from API and NMA 2.

134 See notes 111 and 112 and accompanying text.

135 For example, Merriam-Webster dictionary defines "export" to mean "to carry or send (as a commodity) to some other place (as another country)." Merriam-Webster Dictionary, http://www.merriam-webster.com/dictionary/export (last visited August 15, 2012). See also letters from CRS, Global Financial Integrity 2, and PWYP 1 (stating that exclusion of export activities would be inconsistent with plain language of statute).

"export" to have such a meaning;[136] thus, we believe such a definition would be contrary to the intent of Section 13(q). We also are not persuaded by the argument presented by some commentators[137] that the final rules should be limited only to upstream activities because the reference in the title of Section 13(q) to "Resource Extraction Issuers" demonstrates Congressional intent that the statute should apply only to issuers engaged in extractive activities.[138] Accordingly, under the final rules, "commercial development" includes the export of oil, natural gas, or minerals and, therefore, the definition of "resource extraction issuer" will capture an issuer that engages in the export of oil, natural gas, or minerals. We note that these definitions could require companies that may only be engaged in exporting oil, natural gas, or minerals and that may not have engaged in exploration, extraction, or processing of those resources to provide payment disclosure.

Consistent with the proposal, the definition of "commercial development" in the final rules does not include transportation in the list of covered activities.[139] Section 13(q) does not include transportation in the list of activities covered by the definition of "commercial

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136 See note 118 and accompanying text.

137 See note 105 and accompanying text.

138 The statutory definition of "commercial development" includes activities, such as processing and export, that go beyond mere extractive activities. In this regard, we note that "the title of a statute and the heading of a section cannot limit the plain meaning of the text....For interpretative purposes, they are of use only when they shed light on some ambiguous word or phrase. They are but tools available for the resolution of a doubt. But they cannot undo or limit that which the text makes plain." Brotherhood of Railroad Trainmen v. Baltimore & Ohio Railroad Co., 331 U.S. 519, 528-29 (1947); see also Intel Corporation v. Advanced Micro Devices, Inc., 542 U.S. 241, 256 (2004) (quoting Trainmen).

139 Adopting a definition of "commercial development" that does not include transport activities other than in connection with export is consistent with the EITI, which generally does not require the disclosure of transportation-related payments. See Implementing the EITI, at 35.

development." In addition, including transportation activities within the final rules under Section 13(q) would go beyond what is currently contemplated by the EITI, which focuses on exploration and production activities and does not explicitly include transportation activities.[140] Thus, the final rules do not require a resource extraction issuer to disclose payments made for transporting oil, natural gas, or minerals for a purpose other than export.[141] As recommended by several commentators, transportation activities generally would not be included within the definition[142] unless those activities are directly related to the export of the oil, natural gas, or minerals. For example, under the final rules, transporting a resource to a refinery or smelter, or to underground storage prior to exporting it, would not be considered "commercial development," and therefore, an issuer would not be required to disclose payments related to those activities.

In an effort to emphasize substance over form or characterization and to reduce the risk of evasion, as discussed in more detail below, we are adding an anti-evasion provision to the final rules.[143] The provision requires disclosure with respect to an activity or payment that, although not in form or characterization of one of the categories specified under the

140 See letters from API 1, ExxonMobil 1, and NMA 2.

141 In addition, we note that Section 13(q) does not include transporting in the list of covered activities, unlike another federal statute – the SADA – that specifically includes "transporting" in the definition of "oil and gas activities" and "mineral extraction activities." The inclusion of "transporting" in SADA, in contrast to the language of Section 13(q), suggests that the term was not intended to be included in the scope of Section 13(q).

142 See, e.g., letters from API, Barrick Gold, National Fuel, and NMA 2.

143 See Section II.D.1.c.

final rules, is part of a plan or scheme to evade the disclosure required under Section 13(q).[144] Under this provision, a resource extraction issuer could not avoid disclosure, for example, by re-characterizing an activity that would otherwise be covered under the final rules as transportation.

Consistent with the proposal, the definition of "commercial development" in the final rules would not include marketing in the list of covered activities. Section 13(q) does not include marketing in the list of activities covered by the definition of "commercial development." In addition, including marketing activities within the final rules under Section 13(q) would go beyond what is currently contemplated by the EITI, which focuses on exploration and production activities and does not include marketing activities.[145] Thus, the final rules do not including marketing in the list of covered activities in the definition of "commercial development."[146]

### D. Definition of "Payment"

Section 13(q) defines "payment" to mean a payment that:

- is made to further the commercial development of oil, natural gas, or minerals;
- is not de minimis; and
- includes taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits, that the Commission, consistent with EITI's

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144 See Instruction 9 to Item. 2.01 of Form SD.

145 See letters from API 1 and ExxonMobil 1.

146 For similar reasons, the definition of "commercial development" does not include activities relating to security support. See Section II.D. below for a related discussion of payments for security support.

guidelines (to the extent practicable), determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.

### 1. Types of Payments

#### a. Proposed Rules

In the Proposing Release, we explained that we interpret Section 13(q) to provide that the types of payments that are included in the statutory language should be subject to disclosure under our rules to the extent the Commission determines that the types of payments and any "other material benefits" are part of the "commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals." Consistent with Section 13(q), we proposed to require resource extraction issuers to disclose payments of the types identified in the statute because of our preliminary belief that they are part of the "commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals." We noted that the types of payments listed in Section 13(q) generally are consistent with the types of payments the EITI suggests should be disclosed and expressed our belief that this is evidence that the payment types are part of the commonly recognized revenue stream. As noted above, Section 13(q) provides that our determination should be consistent with the EITI's guidelines, to the extent practicable. Therefore, we are including all the payments listed above in the final rules because they are included in the EITI, which indicates they are part of the commonly recognized revenue stream. Guidance for implementing the EITI suggests that a country's disclosure requirements might include the following benefit streams:[147] production entitlements; profits taxes; royalties; dividends; bonuses, such as signature, discovery, and production bonuses; fees, such as license, rental, and entry fees; and other significant benefits to host governments, including taxes on corporate income, production, and profits but excluding taxes on consumption.[148]

We did not propose specific definitions for each payment type, although we stated that fees and bonuses identified as examples in the EITI would be covered by the proposed rules. In addition, we provided an instruction to the rules to clarify the taxes a resource extraction issuer would be required to disclose. Under the proposal, resource extraction issuers would have been required to disclose taxes on corporate profits, corporate income, and production, but would not have been required to disclose taxes levied on consumption, such as value added taxes, personal income taxes, or sales taxes, because consumption taxes are not typically disclosed under the EITI. We did not propose any other "material benefits" that should be disclosed. Thus, we did not propose to require disclosure of dividends, payments for infrastructure improvements, or social or community payments because those types of payments are not included in the statutory list of payments. We recognized that it may be appropriate to provide more specific guidance about the particular payments that should be disclosed. We requested comment intended to elicit detailed information about what types of payments should be included in, or excluded from, the rules; what additional guidance may be helpful or necessary; and whether there are "other material benefits" that

147 Under the EITI, benefit streams are defined as being any potential source of economic benefit which a host government receives from an extractive industry. See EITI Source Book, at 26.

148 EITI Source Book, at 27-28.

should be specified in the list of payments subject to disclosure because they are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.

### b. Comments on the Proposed Rules

Several commentators supported the proposal and stated that it was not necessary to provide further guidance regarding the types of payments covered or to define "other material benefits" that are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.[149] Those commentators noted that the proposed types of payments were largely consistent with the benefit streams listed in the EITI Source Book and represented the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals. Another commentator agreed the payment types should be based on the benefit streams outlined in the EITI Source Book, and suggested that we provide some limited guidance on the types of payments that should be disclosed to "ensure consistency of presentation and to facilitate the interpretation of the rules."[150]

Several other commentators, however, urged the Commission to adopt a broader, more detailed, and non-exhaustive list of payment types.[151] For example, in addition to the statutory list of payments, some commentators suggested the rule specify as fees required to

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149 See letters from API 1, Chevron, ExxonMobil 1, NMA 2, PetroChina, RDS 1, and Statoil.

150 See letter from BP 1.

151 See letters from Calvert, CRS, Earthworks, Global Witness 1, Le Billon, ONE, PWYP 1, TIAA, and WRI.

be disclosed a wide range of fees, including concession fees, entry fees, leasing and rental fees, which are covered under the EITI, as well as acreage fees, pipeline and other transportation fees, fees for environmental, water and surface use, land use, and construction permits, customs duties, and trade levies.[152] Other commentators opposed the disclosure of any fees or permits that are not unique to the resource extraction industry or that represent ordinary course payments for goods and services to government-owned entities acting in a commercial capacity.[153]

Some commentators agreed that, as proposed, resource extraction issuers should have to disclose taxes on corporate profits, corporate income, and production, but should not be required to disclose taxes levied on consumption.[154] Commentators expressed concern, however, that because corporate income taxes are measured at the entity level, it would be difficult to derive a disaggregated, per project amount for those tax payments.[155] A couple of those commentators noted that compounding this difficulty is the fact that the total amount of income tax paid is a net amount reflecting tax credits and other tax deductions included under commercial arrangements with the host government. Tax credits and deductions may result from offsetting results from one set of projects against credits and deductions of other projects, according to some commentators, and therefore deriving an income tax payment by

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152 See letters from Earthworks (supporting PWYP), CRS, Global Witness 1, Le Billon, ONE, PWYP pre-proposal, and PWYP 1.

153 See letters from Cleary and Vale.

154 See letters from API 1, ExxonMobil 1, NMA 2, and RDS 1.

155 See letters from API 1, BHP Billiton, BP 1, ExxonMobil 1, IAOGP, Petrobras, Statoil, and Talisman.

individual project would be very difficult.[156] Other commentators opposed requiring the disclosure of payments for corporate income taxes because those payments are generally applicable to any business activity and are not specifically made to further the commercial development of oil, natural gas, or minerals.[157] Still other commentators believed that issuers should have to disclose payments for consumption and other types of taxes, including value added taxes, withholding taxes, windfall or excess profits taxes, and environmental taxes.[158] One commentator believed consumption and other taxes should be disclosed to the extent they are "discriminatory taxes targeted at specific industries, as opposed to taxes of general applicability."[159]

Several commentators requested expansion of the proposed list of payment types to include specifically at least those types typically disclosed under the EITI, such as signature, discovery, and production bonuses, and dividends.[160] With regard to dividends, commentators noted that a government or government-owned company often owns shares in a holding company formed to develop and produce resources.[161] In those situations, an issuer may pay dividends to the government or government-controlled company in lieu of royalties

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156 See letters from API 1 and ExxonMobil 1.

157 See letters from Akin Gump Strauss Hauer & Feld LLP (March 2, 2011) and Cleary.

158 See letters from Barrick Gold, Earthworks, and PWYP 1.

159 Letter from AngloGold.

160 See letters from AngloGold, Barrick Gold, ERI 1, Earthworks, ExxonMobil 1, Global Witness 1, ONE, and PWYP 1.

161 See letters from API 1, AngloGold, ERI 1, and ExxonMobil 1.

or production entitlements.[162] One commentator further stated that, unlike the equity share that a private operator would enjoy, in those situations the government participates on a preferential basis not available to other entities.[163] According to commentators, dividends paid to the government or government-owned company in those situations would be a material benefit, reportable under the EITI, and part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.[164] Focusing on the mining industry, one commentator explained that "[o]wnership in the share capital of a holding company that owns a mine is an alternative structure to a production entitlement or royalty interest, and dividends paid are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals."[165]

Other commentators, however, opposed requiring disclosure of dividend payments.[166] According to one commentator, dividends are indirect payments that are outside the core elements of the revenue stream for the commercial development of oil, natural gas or minerals, and therefore should be excluded.[167] Another commentator opposed the inclusion of dividends because of its belief that dividend payments are not generally associated with a

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162 See letters from AngloGold and ERI 1.

163 See letter from ERI 1. This commentator noted that a significant portion of the revenue recognized by the government in such cases comes from its "equity stake in the operation – often known as the production share – or from dividends."

164 See letters from API 1, AngloGold, ExxonMobil 1, and PWYP 1.

165 See letter from AngloGold.

166 See letters from NMA 2, RDS 1, and Statoil.

167 See letter from Statoil.

particular project.[168] A third commentator believed that, because "the term 'dividends' relates to amounts received by the host country government as a shareholder in a state enterprise[,]" dividend payments "essentially are inter-governmental transfers" and therefore are more appropriately reported by the government in an EITI reporting country.[169]

Many commentators supported the inclusion of in-kind payments, particularly in connection with production entitlements.[170] A couple of commentators requested that the Commission add language to the rule text to make explicit that issuers would be permitted to report payments in cash or in kind.[171] Another commentator stated that the Commission should provide instructions concerning how to disclose a production entitlement in kind, including which unit of measure to use, whether to provide a monetary value, and, if so, which currency to use.[172] A couple of commentators suggested allowing companies to report the payments at cost or, if not determinable, at fair market value.[173]

Some commentators did not believe that we need to further identify "other material benefits" that are part of the commonly recognized revenue stream for the commercial

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168 See letter from RDS 1.

169 Letter from NMA 2.

170 See letters from API 1, AngloGold, Barrick Gold, ERI 1, EG Justice (March 29, 2011), ExxonMobil 1, HURFOM 1, Le Billon, NMA 2, Petrobras, RDS 1, TIAA, and WRI. One commentator noted that payments in kind for "infrastructure barter deals" have greatly increased over the past decade. See letter from Le Billon.

171 See letters from ERI 1 and NMA 2.

172 See letter from Petrobras.

173 See letters from AngloGold and NMA 2. NMA also suggested requiring companies to report in-kind payments in the currency of the country in which it is made and not requiring conversion of all payments to the reporting currency.

development of oil, natural gas, or minerals.[174] Other commentators, however, either urged us to provide a broad, non-exclusive definition of "other material benefits" or to specify that certain types of payments should be included under that category because they are part of the commonly recognized revenue stream.[175]

Some commentators suggested that "other material benefits" should include payments for infrastructure improvements because natural resources are frequently located in remote or undeveloped areas, which requires resource extraction issuers, particularly mining companies, to make payments for infrastructure improvements that are generally viewed as part of the cost of doing business in those areas.[176] One commentator stated that payments for infrastructure improvements should be considered part of the commonly recognized revenue stream to the extent that they constitute part of the issuer's overall relationship with the government according to which the issuer engages in the commercial development of oil, natural gas, or minerals, while voluntary payments for infrastructure improvements should be excluded.[177] Another commentator believed that payments for infrastructure improvements should be disclosed even if not required by contract if an issuer undertakes them to build goodwill with the local population.[178]

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174 See letters from API 1, ExxonMobil 1, PetroChina, and RDS 1.

175 See, e.g., letters from AngloGold, Barrick Gold, ERI 1, Earthworks, Global Witness 1, ONE, PWYP 1, Sen. Levin 1, and WRI.

176 See, e.g., letters from ERI 1, Global Witness 1, and PWYP 1.

177 See letter from AngloGold.

178 See letter from ERI 1.

Other commentators opposed requiring the disclosure of payments for infrastructure improvements.[179] One commentator maintained that voluntary payments for infrastructure improvements should not be covered by the rules because they do not constitute part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.[180] Other commentators acknowledged that infrastructure improvements are often funded by issuers as part of the commercial development of oil and gas resources, but those commentators nevertheless believed that such payments should be excluded because they are typically not material compared to the primary types of payments required to be disclosed under Section 13(q).[181] Another commentator stated that payments for infrastructure improvements are of a de minimis nature compared to the overall costs of the commercial development of oil, natural gas, or minerals and, in many cases, are paid to private parties and not to government agencies.[182]

Several commentators recommended defining "other material benefits" to include social or community payments related to, for example, improvements of a host country's schools, hospitals, or universities.[183] While some commentators believed that, at a minimum, social or community payments should be included if required under the investment contract

179 See letters from API 1, ExxonMobil 1, NMA 2, RDS 1, and Statoil.

180 See letter from NMA 2.

181 See letters from API 1 and ExxonMobil 1. See also letter from Statoil (stating that payments for infrastructure improvements are indirect payments that are not part of the core elements of the revenue stream for the commercial development of oil, natural gas, or minerals).

182 See letter from RDS 1.

183 See letters from AngloGold, Barrick Gold, ERI 1, Earthworks, EG Justice, ONE, PWYP 1, Sen. Levin 1, and WRI.

or the law of the host country,[184] other commentators suggested that voluntary social or community payments should be included as "other material benefits" because they represent an in-kind contribution to the state that, given their frequency, constitute part of the commonly recognized revenue stream of resource extraction.[185] One commentator noted that the Board of the EITI approved a revision to the EITI rules that would encourage EITI participants to disclose social payments that are material.[186] Some commentators also sought to include within the scope of "other material benefits" other types of payments, such as payments for security, personnel training, technology transfer, and local content and supply requirements, if required by the production contract.[187]

Several other commentators, however, maintained that social or community payments or other ancillary payments are considered indirect benefits under EITI guidelines, are typically not material, and therefore are not part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.[188] Another commentator stated that payments for social and community needs and ancillary payments should be

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184 See letters from AngloGold, EG Justice (noting that in at least one country, Equatorial Guinea, companies engaged in upstream oil activities are required by that country's hydrocarbons law to invest in the country's development), ONE, and PWYP 1.

185 See letters from Barrick Gold, ERI 1, Earthworks, and WRI.

186 See letter from PWYP 1.

187 See, e.g., letters from ERI 1, Global Witness 1, and PWYP 1.

188 See letters from API 1, ExxonMobil 1, PetroChina, RDS 1, and Statoil.

excluded from the final rules unless they are expressly required by the concession contract, law, or regulation.[189]

### c. Final Rules

While we are adopting the list of payment types largely as proposed, we are making some additions and clarifications to the list of payment types in response to comments. Specifically, the final rules are consistent with the definition of payment in Section 13(q) and state that the term "payment" includes:

- taxes;
- royalties;
- fees;
- production entitlements;
- bonuses;
- dividends; and
- payments for infrastructure improvements.[190]

As we noted in the Proposing Release and above, we interpret Section 13(q) to provide that the types of payments that are included in the statutory language should be subject to disclosure under our rules to the extent that the Commission determines that the

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189 See letter from NMA 2.

190 Under Section 13(q) and the final rules, the term "payment" is defined as a payment that is not de minimis, that is made to further the commercial development of oil, natural gas, or minerals, and includes specified types of payments. Thus, in determining whether disclosure is required, resource extraction issuers will need to consider whether they have made payments that fall within the specified types and otherwise meet the definition of payment.

types of payments and any "other material benefits" are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals. As noted, the statute provides that our determination should be consistent with the EITI's guidelines, to the extent practicable. Therefore, we are including all the payments listed above in the final rules because they are part of the commonly recognized revenue stream. We do not believe the final rules should include a broad, non-exhaustive list of payment types or category of "other material benefits," as was suggested by some commentators,[191] because we do not believe including a broad, non-exclusive category would be consistent with our interpretation that the Commission must determine the "material benefits" that are part of the commonly recognized revenue stream. Thus, under the final rules, resource extraction issuers will be required to disclose only those payments that fall within the specified list of payment types in the rules, which include payment types that we have determined to be material benefits that are part of the commonly recognized revenue stream, and that otherwise meet the definition of "payment."

We agree generally with those commentators who stated that it would be appropriate to add the types of payments included under the EITI but not explicitly mentioned under Section 13(q) to the list of payment types required to be disclosed because their inclusion under the EITI is evidence that they are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.[192] Accordingly, the final rules

191 See note 175 and accompanying text.

192 See, e.g., letter from AngloGold.

add dividends to the list of payment types required to be disclosed.[193] The final rules clarify in an instruction that a resource extraction issuer generally need not disclose dividends paid to a government as a common or ordinary shareholder of the issuer as long as the dividend is paid to the government under the same terms as other shareholders. The issuer will however be required to disclose any dividends paid to a government in lieu of production entitlements or royalties.[194] We agree with the commentators that stated ordinary dividends would not comprise part of the commonly recognized revenue stream because such dividend payments are not made to further the commercial development of oil, natural gas, or minerals,[195] except in cases where the dividend is paid to a government in lieu of production entitlements or royalties.

The final rules also include, in the list of payment types subject to disclosure, payments for infrastructure improvements, such as building a road or railway. Several commentators stated that, because resource extraction issuers often make payments for infrastructure improvements either as required by contract or voluntarily, those payments constitute other material benefits that are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.[196] We further note that some

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193 The EITI describes dividends as "dividends paid to the host government as shareholder of the national state-owned company in respect of shares and any profit distributions in respect of any form of capital other than debt or loan capital." EITI Source Book, at 27-28.

194 See Instruction 7 to Item 2.01.

195 See letters from Cleary and Statoil.

196 See letters from AngloGold, Barrick Gold, ERI 1, Earthworks, EG Justice, Global Witness 1, ONE, and PWYP 1.

EITI participants have included infrastructure improvements within the scope of their EITI program, even though those payments were not required under the EITI until recently.[197] In February 2011 the EITI Board issued revised EITI rules[198] that require participants to develop a process to disclose infrastructure payments under an EITI program.[199] Thus, including infrastructure payments within the list of payment types required to be disclosed under the final rules will make the rules more consistent with the EITI, as directed by the statute.

Under the final rules, consistent with the recommendation of some commentators,[200] a resource extraction issuer must disclose payments that are not de minimis that it has made to a foreign government or the U.S. Federal Government for infrastructure improvements if it has incurred those payments, whether by contract or otherwise, to further the commercial development of oil, natural gas, or minerals. For example, payments required to build roads

197 See the 2009 EITI report for Ghana (reported under Mineral Development Fund contributions), the 2008 EITI report for the Kyrgyz Republic (reported under social and industrial infrastructure payments), the 2008-2009 EITI report for Liberia (reported under county and community contributions), and the 2008 EITI report for Mongolia (reported under donations to government organizations).

198 See EITI Rules 2011, available at http://eiti.org/document/rules.

199 See EITI Requirement 9(f) in EITI Rules 2011, at 24 ("Where agreements based on in-kind payments, infrastructure provision or other barter-type arrangements play a significant role in the oil, gas or mining sectors, the multi-stakeholder group is required to agree [to] a mechanism for incorporating benefit streams under these agreements in to its EITI reporting process...."). The EITI Board has established a procedure to implement the new rules. According to the procedure, any country admitted as an EITI candidate on or after July 1, 2011 must comply with the new rules. Compliant countries are encouraged to make the transition to the new rules as soon as possible. The procedure also establishes a transition schedule for countries that are implementing the EITI but are not yet compliant. See the EITI newsletter, available at http://eiti.org/news-events/eiti-board-agrees-transition-procedures-2011-edition-eiti-rules.

200 See note 176 and accompanying text.

to gain access to resources for extraction would be covered by the final rules. If an issuer is obligated to build a road rather than paying the host country government to build the road, the issuer would be required to disclose the cost of building the road as a payment to the government to the extent that the payment was not de minimis.[201]

The final rules do not require a resource extraction issuer to disclose social or community payments, such as payments to build a hospital or school, because it is not clear that these types of payments are part of the commonly recognized revenue stream. We note commentators' views on whether social or community payments should be included varied more than their views on whether payments for infrastructure improvements should be included. Further, this treatment of social or community payments is consistent with the EITI, which encourages, but does not require, EITI participants to include social payments and transfers in EITI programs if the participants deem the payments to be material.[202]

Consistent with the proposal and Section 13(q), the final rules will require a resource extraction issuer to disclose fees, including license fees, and bonuses paid to further the commercial development of oil, natural gas, or minerals. In response to requests by some commentators,[203] we are adding an instruction to clarify that fees include rental fees, entry

[201] For a discussion of the treatment of in-kind payments under the final rules, see the text accompanying note 212. We note some commentators suggested infrastructure payments are usually not material compared to the other types of payments required to be disclosed under Section 13(q) and that infrastructure payments are of a de minimis nature compared to the overall costs of commercial development. See API 1, ExxonMobil 1, RDS 1, and Statoil. As discussed further below, the not de minimis requirement applies to all payment types, not just infrastructure payments.

[202] See EITI Requirement 9(g) in EITI Rules 2011, at 24. Resource extraction issuers could, of course, voluntarily include information about these types of payments in their disclosure on Form SD.

[203] See note 160 and accompanying text.

fees, and concession fees, and bonuses include signature, discovery, and production bonuses.[204] As commentators noted,[205] the EITI Source Book specifically mentions these types of fees and bonuses as payments that are typically disclosed by EITI participants.[206] We believe this demonstrates that these types of fees and bonuses are part of the commonly recognized revenue stream, and therefore the final rules include an instruction clarifying that disclosure of these payments is required. The fees and bonuses identified are not an exclusive list, and there may be other fees and bonuses a resource extraction issuer would be required to disclose. A resource extraction issuer will need to consider whether payments it makes fall within the payment types covered by the rules.

Consistent with the proposal and Section 13(q), the final rules will require a resource extraction issuer to disclose taxes. In addition, the final rules include an instruction, as proposed, to clarify that a resource extraction issuer will be required to disclose payments for taxes levied on corporate profits, corporate income, and production, but will not be required to disclose payments for taxes levied on consumption, such as value added taxes, personal income taxes, or sales taxes.[207] This approach is consistent with the statute, which includes taxes in the list of payment types required to be disclosed, and with the EITI.[208] In response

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204 See Instruction 6 to Item 2.01 of Form SD.

205 See, e.g., letters from API 1 and ExxonMobil 1.

206 See the EITI Source Book, at 28.

207 See Instruction 5 to Item 2.01 of Form SD.

208 The EITI Source Book specifically mentions the inclusion of taxes levied on income, production or profits and the exclusion of taxes levied on consumption, such as value-added taxes, personal income taxes or sales taxes. See the EITI Source Book, at 28.

to concerns expressed about the difficulty of allocating certain payments that are made for obligations levied at the entity level, such as corporate taxes, to the project level,[209] the final rules provide that issuers may disclose those payments at the entity level rather than the project level.[210]

We are not persuaded that there are other types of payments that currently constitute material benefits that are part of the commonly recognized revenue stream. Therefore, the final rules do not include any additional payment types in the list of payment types resource extraction issuers must disclose.

As previously noted, many commentators supported the inclusion of in-kind payments, particularly in connection with production entitlements.[211] Under the final rules, resource extraction issuers must disclose payments of the types identified in the rules that are made in kind.[212] Because Section 13(q) specifies that the final rules require the disclosure of the type and total amount of payments made for each project and to each government, issuers will need to determine the monetary value of in-kind payments.[213] Consistent with

209 See note 155 and accompanying text.

210 See discussion in Section II.F.2.c below.

211 See note 170 and accompanying text. In-kind payments include, for example, making a payment to a government in oil rather than a monetary payment.

212 We note that this is consistent with the reporting of production entitlements under the EITI. See the EITI Source Book, at 27.

213 Although a couple of commentators suggested that issuers be permitted to report payments in cash or in kind, we note that Section 13(q) requires the type and total amount of payments made for each project and to each government, and total amount of payments by category. In order for issuers to provide a these total amounts, we believe it is necessary to provide a monetary value for any in-kind payments. Thus, the final rules require that issuers provide a monetary value for payments made in

suggestions we received on disclosing these types of payments,[214] the final rules specify that issuers may report in-kind payments at cost, or if cost is not determinable, fair market value, and provide a brief description of how the monetary value was calculated.[215]

Finally, a resource extraction issuer may not conceal the true nature of payments or activities that otherwise would fall within the scope of the final rules, or create a false impression of the manner in which it makes payments, in order to circumvent the disclosure requirements. As suggested by one commentator,[216] to address the potential for circumvention of the disclosure requirements, the final rules include an anti-evasion provision. This provision is intended to emphasize the substance over the form or characterization of an activity or payment. For example, a resource extraction issuer that typically engages in a particular activity that otherwise would be covered under the definition of commercial development of oil, natural gas, or minerals, and that changes the way it categorizes the same activity after the issuance of final rules to avoid disclosing payments related to the activity may be viewed as seeking to evade the disclosure requirements. Similarly, a resource extraction issuer that typically makes payments of the type that would otherwise be covered under the final rules and that changes the way it categorizes or makes payments after issuance of the final rules so that the payments are not technically required to

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kind. In addition, in light of the requirement in Section 13(q) to tag the information to identify the currency in which the payments were made, the final rules instruct issuers providing a monetary value for in-kind payments to tag the information as "in kind" for purposes of the currency tag.

214 See note 173 and accompanying text.

215 See Instruction 1 to Item 2.01 of Form SD.

216 See letter from Sen. Levin (February 17, 2012) ("Sen. Levin 2").

be disclosed may be viewed as seeking to evade the disclosure requirements. The final rules will require disclosure with respect to activities or payments that, although not in form or characterization of one of the categories specified under the final rules, are part of a plan or scheme to evade the disclosure requirements under Section 13(q).[217]

**2. The "Not De Minimis" Requirement**

**a. Proposed Rules**

Section 13(q) and the proposal define payment, in part, to be a payment that is "not de minimis." Neither the statute nor the proposed rules define "not de minimis." Under Section 13(q) and the proposal, if the other standards for disclosure are met, resource extraction issuers would be required to disclose payments made that are "not de minimis."

Under the EITI, countries are free to establish a materiality level for disclosure.[218] Section 13(q) established the threshold for payment disclosure as "not de minimis" rather than requiring disclosure of "material" payments. Given the use of the phrase "not de

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217 See Instruction 9 to Item 2.01 of Form SD.

218 For example, countries may establish a materiality level based on the size of payments or the size of companies subject to disclosure. See Implementing the EITI, at 30. The EITI Source Book notes that a benefit stream is material "if its omission or misstatement could distort the final EITI report" for the country. EITI Source Book, at 26. Because there is no pre-determined materiality level prescribed for all countries implementing the EITI, the multi-stakeholder group in each EITI-implementing country determines the threshold for disclosure that is appropriate for that country. See Implementing the EITI, at 31. The EITI recommends the following alternatives for considering a benefit stream to be material:

| | |
|---|---|
| "Alternative 1: | [if it is] more than A% of the host government's estimated total production value for the reporting period;' |
| Alternative 2: | [if it is] more than B% of the company's estimated total production value in the host country for the reporting period; or |
| Alternative 3: | [if it is] more than USD C million [or local currency D million]." |

EITI Source Book, at 27.

minimis," we stated in the Proposing Release our preliminary belief that "not de minimis" does not equate with a materiality standard. In doing so, we noted that that the term "de minimis" is generally defined as something that is "lacking significance or importance" or "so minor as to merit disregard."[219] We also noted that we preliminarily believed that the term is sufficiently clear and that further explication was unnecessary.

**b. Comments on the Proposed Rules**

We received significant comment on this aspect of the proposal. Some commentators agreed that it is not necessary to define "not de minimis."[220] Two of those commentators suggested that an issuer should be required to disclose the methodology used to determine what is "not de minimis."[221] One commentator noted that "not de minimis" is a commonly-understood term.[222]

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219 See the definition of "de minimis" in Merriam-Webster Dictionary, available at http://www.merriam-webster.com/dictionary/deminimis. We note, in contrast, that Rule 12b-2 under the Exchange Act [17 CFR 240.12b-2] defines "material" when used to qualify a requirement for the furnishing of information as to any subject, as limited to information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered. See also Rule 405 under the Securities Act [17 CFR 230.405]. In addition, the U.S. Supreme Court has held that, in a securities fraud suit, an omitted fact is material if there is a substantial likelihood that its disclosure would have been considered significant by a reasonable investor. See Basic Inc. v. Levinson, 485 U.S. 224 (1988) and TSC Industries. Inc., et al. v. Northway, Inc., 426 U.S. 438 (1976).

220 See letters from Cleary, Global Witness 1, NMA 2, PetroChina, and Rio Tinto.

221 See letters from NMA 2 and Rio Tinto.

222 See letter from Global Witness 1. This commentator suggested that, in the alternative, we should define the term as an amount that meets or exceeds the lesser of 1) $1,000 for an individual payment or $15,000 in the aggregate over a period, or 2) a particular percentage of the issuer's per project expenditures. It also noted that it believes "not de minimis" should be assessed relative to the total expenditures on a project and not relative to the size or valuation of the entity making the payments.

Most commentators that addressed the issue urged the Commission to define "not de minimis."[223] Several commentators stated that the Commission should avoid adopting a definition that uses one or more quantitative measures and, instead, should define "not de minimis" to mean material.[224] According to those commentators, a definition based on materiality would be consistent with the EITI and the Commission's longstanding disclosure regime.[225] One commentator stated that adopting a definition of "not de minimis" based on materiality would encourage "reasonable consistency of disclosure across all issuers" and result "in the disclosure of all material facts necessary for investors" without the Commission having to provide further guidance on how to determine materiality.[226]

Other commentators, however, agreed with our belief that "not de minimis" does not equate with material.[227] Several commentators noted that a provision of the U.S. federal tax code includes the following definition of "de minimis": "[a] property or service the value of which is. . .so small as to make accounting for it unreasonable or administratively

223 See, e.g., letters from AngloGold, Barrick Gold, BP 1, CalSTRS, Calvert, CRS, Earthworks, Harrington Investments, Inc. (January 19, 2011) ("HII), RDS 1, Sen. Levin 1, and SIF.

224 See letters from API 1, BP 1, Chevron, ExxonMobil 1, RDS 1, and Statoil.

225 See, e.g., letters from API 1 and Chevron. According to one commentator, adopting a definition based on specific quantitative measures rather than existing materiality guidance would "substantially increase the likelihood of overburdening issuers and users with large volumes of unnecessary and immaterial detail...and significantly increase the regulatory burden and cost of compliance." See letter from Chevron. See also letters from API 1 and ExxonMobil 1. Other commentators believed that an issuer should be able to rely on materiality principles for guidance when determining whether a payment is "not de minimis," but did not think that a definition of "not de minimis" was necessary. See letters from Cleary, NMA 2, PetroChina, and Rio Tinto.

226 See letter from API 1.

227 See, e.g., letters from Barrick Gold, Calvert, ERI 1, Global Witness 1, HURFOM 1, PWYP 1, and TIAA.

impracticable."[228] One commentator stated that if we were to adopt a qualitative, principle-based standard when defining de minimis, it should be based on "the relevance of a payment in relation to a country's size" rather than with regard to a company's overall payments, assets or similar metric.[229] A few commentators requested "that a reasonable minimum threshold for payments to be reported should be set" without suggesting a particular minimum threshold.[230]

Several commentators urged us to adopt a definition of "not de minimis" based on one or more quantitative measures.[231] Commentators stated that such a definition was necessary to provide clarity regarding the disclosure requirements.[232] Two commentators suggested using an absolute dollar amount in the definition because they believed that such a standard would be easier to apply than a percentage, would reduce compliance costs, and would help ensure consistent disclosure and comparability.[233] Another commentator

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228 Letter from Calvert (quoting 26 U.S.C. §132(e)(1)); see also letters from Global Witness 1, PWYP 1, and TIAA.

229 See letter from PWYP 1.

230 See letters from Derecho, Greenpeace, and Guatemalan Forest Communities.

231 See letters from AngloGold, Barrick Gold, CalSTRS, CRS, Earthworks, HII, PWYP 1 (suggesting both qualitative and quantitative standards), RWI 1, Sen. Levin 1, and SIF. Another commentator noted that we have adopted objective standards in other contexts and requested that we do so for the definition of "not de minimis." That commentator further suggested that we may need to adopt different quantitative standards for large-cap and small-cap companies, but it did not recommend particular standards. See letter from AXPC.

232 See letters from Barrick Gold and Talisman.

233 See letters from AngloGold (recommending defining "de minimis" to mean "any payment or series of related payments made at the tax-paying entity level which in the aggregate is less than U.S.$1,000,000") and CRS (recommending an amount "significantly less than $100,000" and as an aggregate of payments of the same type during the reporting period covered).

similarly believed that the use of an absolute dollar amount would help level the playing field among issuers.[234]

Commentators offered various suggestions for a quantitative threshold. Some commentators suggested requiring the reporting of payments above $10,000.[235] In addition, numerous commentators signed a petition supporting a de minimis threshold "in the low thousands (U.S. dollars) to prevent millions of dollars from going unreported."[236] Several commentators suggested that we should define "not de minimis" using a standard similar to a listing standard of the London Stock Exchange's Alternative Investment Market ("AIM"), which requires disclosure of any payment made to any government or regulatory authority by an oil, gas, or mining company registrant that, alone or as a whole, is over £10,000, or approximately $15,000.[237] One commentator suggested a reporting threshold "in the tens of thousands."[238] Another commentator believed that we should provide a specific threshold

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234 See letter from Talisman (noting that it currently reports payments in excess of one million dollars and supporting a minimum level of reporting of one million dollars).

235 See letters designated "Type B" (suggesting $10,000 threshold without elaboration) and letter from Le Billon (stating that a "minimal value of $10,000 would be consistent with many legislations seeking to track financial flows, e.g. for the purpose of money laundering").

236 ONE Petition.

237 See letters from CalSTRS, HII, RWI 1, Sen. Levin 1, SIF, and WACAM. Several commentators suggested defining the term further to require disclosure of any individual payment that exceeded $1,000 as well as payments of the same type that in the aggregate exceeded $15,000. See letters from Earthworks, Global Witness 1, Global Witness 3, and PWYP 1.

238 See letter from Global Movement for Budget Transparency, Accountability and Participation (March 30, 2012) ("BTAP").

and that it should be significantly less than $100,000.[239] The commentator further stated that the threshold should be defined as an aggregate of payments of the same type during the reporting period covered. Another commentator suggested using an absolute dollar amount that would vary depending on the size of an issuer's market capitalization.[240]

One commentator suggested defining "de minimis" to mean "any payment or series of related payments made at the tax-paying entity level which in the aggregate is less than U.S.$1,000,000."[241] Another commentator similarly suggested using an absolute dollar amount threshold of $1,000,000 while noting that it currently reports payments in excess of that amount. According to that commentator, its "experience supports [$1,000,000] as the minimum level of reporting to ensure that the objectives of revenue transparency are met while not clouding the data with largely irrelevant information."[242] One commentator, however, opposed a "not de minimis" threshold of $1,000,000 because it believed such a threshold would exclude many payments made in the extractive industry.[243] Another commentator similarly cautioned against setting the "not de minimis" threshold too high

239 See letter from CRS. See also letter from PWYP 1 (stating that $100,000 would not be an appropriate de minimis threshold because $100,000 could exceed the annual payments, such as lease rents or license fees, in some projects).

240 See letter from AXPC. That commentator, however, did not specify any particular dollar amount or corresponding size of market capitalization.

241 See letter from AngloGold.

242 Letter from Talisman.

243 See letter from ERI 3 (referring to disclosure in Sierra Leone's 2010 EITI Report and noting that a $1,000,000 threshold would exclude payments for half of the companies reporting in Sierra Leone). See also ONE Petition (urging the Commission to adopt a final rule that "sets the de minimis threshold in the low thousands (U.S. dollars) to prevent millions of dollars from going unreported").

because it would leave important payment streams undisclosed and could encourage companies and governments to structure payments in future contracts in a way that would avoid the disclosure requirement.[244]

Other commentators suggested adopting a quantitative definition of "not de minimis" that uses a relative measure, either alone or with an absolute dollar amount.[245] One commentator suggested defining "not de minimis" to mean five percent or more of an issuer's upstream expenses or revenues.[246] Another commentator suggested defining "not de minimis" as the lesser of two percent of the issuer's consolidated expenditures and $1,000,000.[247] According to that commentator, using a standard based on the lesser of a dollar amount or a percentage of expenses would reflect the size of a company but still ensure the disclosure of significant payments by a larger company.[248]

#### c. Final Rules

We have determined to adopt a definition of "not de minimis" to provide clear guidance regarding when a resource extraction issuer must disclose a payment.[249] We have considered whether to define the term using a materiality standard, as some commentators

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244 See letter from Rep. Frank et al.

245 See letters from Barrick Gold and RDS 1 (RDS suggested a quantitative definition if the Commission determines not to define the term as "material").

246 See letter from RDS 1.

247 See letter from Barrick Gold (suggested "consolidated expenditures" but did not provide an explanation of the term).

248 See letter of Barrick Gold.

249 See, e.g., letters from Barrick Gold and Talisman.

have recommended.[250] We continue to believe that given the use of the phrase "not de minimis" in Section 13(q) rather than use of a materiality standard, which is used elsewhere in the federal securities laws and in the EITI,[251] "not de minimis" was not intended to equate to a materiality standard.

More fundamentally, for purposes of Section 13(q), we do not believe the relevant point of reference for assessing whether a payment is "not de minimis" is the particular issuer. Rather, because the disclosure is designed to further international transparency initiatives regarding payments to governments for the commercial development of oil, natural gas, or minerals, we think the better way to consider whether a payment is "not de minimis" is in relation to host countries. We recognize that issuers may have difficulty assessing the significance of particular payments for particular countries or recipient governments and, as explained below, are adopting a $100,000 threshold that, we believe, will facilitate compliance with the statute by providing clear guidance regarding the payments that resource extraction issuers will need to track and report and will promote the transparency goals of the statute. In addition, we believe the threshold we are adopting will result in a lesser compliance burden than would otherwise be associated with the final rules if a lower threshold were used because issuers may track and report fewer payments than they would be required to report if a lower threshold was adopted.

250 See note 224 and accompanying text.

251 See note 218 and accompanying text.

Of the suggested approaches for defining "not de minimis," we believe that a standard based on an absolute dollar amount is the most appropriate because it will be easier to apply than a qualitative standard or a relative quantitative standard based on a percentage of expenses or revenues of the issuer,[252] or some other fluctuating measure, such as a percentage of the host government's or issuer's estimated total production value in the host country for the reporting period. Using an absolute dollar amount threshold for disclosure purposes should help reduce compliance costs and may also promote consistency and comparability.[253]

The final rules define "not de minimis"[254] to mean any payment, whether made as a single payment or series of related payments, that equals or exceeds $100,000 during the most recent fiscal year.[255] The final rules provide that in the case of any arrangement providing for periodic payments or installments (e.g., rental fees), a resource extraction issuer must consider the aggregate amount of the related periodic payments or installments of the related payments in determining whether the payment threshold has been met for that series of payments, and accordingly, whether disclosure is required.[256] As discussed further below,

252 See notes 231-233 and accompanying text.

253 See note 233and accompanying text. Furthermore, some commentators who suggested a relative standard did not provide definitions, or suggested a standard based on upstream payments only even though the required disclosure includes additional payments.

254 See Item 2.01(c)(7) of Form SD.

255 For example, a resource extraction issuer that paid a $150,000 signature bonus would be required to disclose that payment. As another example, a resource extraction issuer obligated to pay royalties to a government annually and that paid $10,000 in royalties on a monthly basis to satisfy its obligation would be required to disclose $120,000 in royalties.

256 See Item 2.01(c)(7) of Form SD. This is similar to other instructions in our rules requiring disclosure of a series of payments. See, e.g., Instructions 2 and 3 to Item 404(a) of Regulation S-K (17 CFR 229.404(a)).

we considered a variety of alternatives when considering what, if any, definition would be appropriate for "not de minimis."

We believe that a $100,000 threshold is more appropriate than, and an acceptable compromise to, the amounts suggested by commentators.[257] Commentators supporting an absolute dollar amount differed widely on the amount best suited for the threshold, with commentators suggesting an amount in the "low thousands" of U.S. dollars,[258] $10,000,[259] $15,000,[260] an amount less than $100,000,[261] and $1,000,000.[262] We are not adopting a threshold in the low thousands of U.S. dollars, $10,000, or $15,000 threshold. In light of the comments received, we are concerned that those amounts could result in undue compliance burdens and raise competitive concerns for many issuers. While supporters of a $15,000 threshold noted its similarity to the AIM listing requirement, we do not believe that applying

257 The Proposing Release solicited comment on a wide range of absolute dollar amounts for the "de minimis" threshold, and requested data to support the definitions suggested by commentators. See Part II.D.2. of the Proposing Release. We received little data that was helpful. Although one commentator submitted data regarding payments made by some oil companies for tuition, rent, and living expenses for the students and relatives of officials in Equatorial Guinea, those payments are not within the list of payments types specified by Section 13(q). See letter from Sen. Levin 2. Another commentator noted that, based on Sierra Leone's 2007 EITI Reconciliation Report (published in 2010), a $1 million threshold would result in non-disclosure of over 40% of payments made by mining companies and all payments made by half of EITI reporting companies in that country. See letter from ERI 3. Although the letter provides information about payments made to Sierra Leone, it appears that the companies for which data is provided would not be subject to the reporting requirements under Section 13(q) and the related rules.

258 See ONE Petition.

259 See letters designated Type B and letter from Le Billon.

260 See letters from CalSTRS, ERI 3, HII, RWI 1, Sen. Levin 1, SIF, and WACAM.

261 See letters from CRS and PWYP 1.

262 See letters from AngloGold and Talisman; see also letter from Barrick Gold.

the threshold used in that listing requirement is appropriate for purposes of Section 13(q) because that threshold was designed to apply to the smaller companies that comprise the AIM market.[263]

Although a few commentators suggested we use $1,000,000 as the threshold,[264] including one commentator that stated it reports payments to governments in excess of $1,000,000,[265] we do not believe that $1,000,000 would be an appropriate threshold. While many EITI-reporting companies have reported payments in excess of $1,000,000,[266] we note that the EITI provides that countries may establish a "materiality" level for disclosure, which, as noted, is different from the "not de minimis" standard in Section 13(q). We agree with those commentators that cautioned against setting the threshold too high so as to leave important payment streams undisclosed.[267] Adopting $100,000 as the "not de minimis" threshold furthers the purpose of Section 13(q) and will result in a lesser compliance burden than would otherwise be associated with the final rules if a lower threshold were used.

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263 We also note that the AIM requirement differs from the disclosure required by Section 13(q) and the final rules in that the AIM only requires disclosure of payments by extractive issuers as an initial listing requirement and does not impose an ongoing reporting requirement related to those payments.

264 See letters from AngloGold, Barrick Gold, and Talisman.

265 See letter from Talisman.

266 See, e.g., the 2009 EITI Report for Ghana (regarding payment of royalties, corporate taxes, and dividends); the 2006-2008 EITI Report for Nigeria (regarding payment of petroleum taxes, royalties and signature bonuses); the 2004-2007 EITI Report for Peru (regarding payment of corporate income taxes and royalties); and the 2009 EITI Report for Timor Leste (regarding payment of petroleum taxes).

267 See letters from ERI 3 and Rep. Frank et al.

Although adoption of a $100,000 threshold may be viewed as somewhat high by some commentators[268] and may result in some smaller payments not being reported, we believe this threshold strikes an appropriate balance between concerns about the potential compliance burdens of a lower threshold and the need to fulfill the statutory directive that payments greater than a "de minimis" amount be covered. We acknowledge that a "not de minimis" definition based on a materiality standard, or a much higher amount, such as $1,000,000, would lessen commentators' concerns about the compliance burden and potential for competitive harm.[269] We believe, however, that use of the term "not de minimis" in Section 13(q) indicates that a threshold quite different from a materiality standard, and significantly less than $1,000,000, is necessary to further the transparency goals of the statute.

In adopting the final rules, we believe an absolute, rather than relative, threshold may make the requirement easier for issuers to comply with and allow for increased comparability of payment disclosures. We considered adopting a threshold that would have required disclosure of the lesser of a specific dollar amount or a percentage of expenses, as suggested by commentators.[270] We determined not to adopt such an approach because we agree with other commentators that noted such an approach would be more difficult for issuers to comply with, could raise the compliance costs associated with tracking and reporting the

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268 See, e.g., letters from CRS (supporting a "not de minimis" threshold that is significantly less than $100,000) and PWYP 1 (supporting a "not de minimis" threshold of $1,000 for individual payments and $15,000 for payments in the aggregate); see also letter from ERI 3.

269 See notes 224, 241, and 242 and accompanying text.

270 See note 247 and accompanying text.

information, and would make comparability of disclosure more difficult.[271] For similar reasons, we decided not to adopt a threshold that exclusively used a percentage threshold based on an issuer's expenses or revenues, or some other fluctuating measure. We note that exclusively using a percentage threshold based on an issuer's expenses or revenues could result in larger companies having a higher payment threshold for disclosure than contemplated by the "de minimis" language in the statute.

### 3. The Requirement to Provide Disclosure for "Each Project"

#### a. Proposed Rules

As noted in the proposal, Section 13(q) requires a resource extraction issuer to disclose information regarding the type and total amount of payments made to a foreign government or the Federal Government for each project relating to the commercial development of oil, natural gas, or minerals, but it does not define the term "project."[272] Consistent with Section 13(q), the proposed rules would have required a resource extraction issuer to disclose payments made to governments by type and total amount per project. The proposed rules did not define "project" in light of the fact that neither Section 13(q) nor our current disclosure rules include a definition of the term. In addition, the EITI does not define the term or provide guidance on how it should be defined.

#### b. Comments on the Proposed Rules

[271] See note 233 and accompanying text.

[272] The legislative history does not provide an indication as to how we should define the term.

Two commentators supported the proposed approach of leaving the term "project" undefined to allow flexibility for different types and sizes of businesses.[273] Most commentators that addressed the issue supported defining the term "project,"[274] but they disagreed as to the appropriate definition, with recommendations ranging from defining a "project" as each individual lease or license to defining it as a country. One commentator stated that leaving the term undefined "would create significant uncertainty for issuers and result in disclosures that are not comparable from issuer to issuer."[275] Several commentators urged us to adopt a definition of project that would not impede the ability of companies to compete for extractive industry contracts, but did not provide a particular definition.[276] One of those commentators recommended broadly defining "project" so that issuers would not have to disclose disaggregated price and cost information that could have anti-competitive effects.[277] Another of those commentators stated that we must adopt a definition of "project," among other definitions, that is "narrowly tailored to prevent a competitive imbalance for those SEC-registered companies which make payments to governments for the privilege of extracting natural resources."[278]

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273 See letters from Cleary and NMA 2.

274 See, e.g., letters from API 1, Calvert, Chevron, PWYP 1, RDS 1, and Sen. Levin 1.

275 Letter from API 1.

276 See letters from Chairman Bachus and Chairman Miller, Timothy J. Muris and Bilal Sayyed (March 2, 2011) ("Muris and Sayyed"), and Split Rock.

277 See letter from Muris and Sayyed.

278 Letter from Chairman Bachus and Chairman Miller.

Some commentators suggested that we permit a resource extraction issuer to treat all of its operations in a single country as a project.[279] Commentators asserted that doing so would be consistent with the EITI and would prevent issuers from incurring tens of millions of dollars in compliance costs.[280] One commentator stated that defining "project" to require country-level disclosure would be consistent with Item 1200 of Regulation S-K, which treats an individual country as the lowest geographic level at which comprehensive oil and gas disclosures must be provided.[281] Commentators that opposed defining "project" as a country stated that such a definition would be inconsistent with the statute and Congressional intent.[282]

Other commentators supported defining "project" consistent with the definition of "reporting unit."[283] According to one of those commentators, using a definition consistent with reporting unit "would allow issuers to collect information on a basis with which they already are familiar, and draw upon established internal controls over financial reporting

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279 See letters from AXPC, AngloGold, Barrick Gold, bcIMC, BHP Billiton, BP 1, Hispanic Leadership Fund (February 27, 2012), Petrobras, PWC, RDS 1, Sen. Murkowski and Sen. Cornyn, and Statoil. See also letters from API 1 and ExxonMobil 1 (stating that under certain circumstances, an issuer should be permitted to treat operations in a country as a project, for example, when all of an issuer's operations in a country relate to a single geologic basin or province).

280 See letters from API 1, ExxonMobil 1, Petrobras, and RDS 1.

281 See letter from PWC.

282 See, e.g., letters from Calvert, Earthworks, Global Financial 2, Global Witness 1, HURFOM 2, ONE, Oxfam 1, PWYP 1, Rep. Frank et al., and Sen. Cardin et al 1. See also letter from Gates Foundation and Le Billon.

283 See letters from API 1, Chevron, ExxonMobil 1, NMA 2, Rio Tinto, and Talisman. Generally, the commentators did not specify what they meant by reporting unit, but we assume that they were referring to a reporting unit as used for financial reporting purposes. See also note 305.

("ICFR"), instead of having to reallocate and assign payments arbitrarily at a lower or different level than which they manage their operations, and incurring cost and burden beyond their existing ICFR systems."[284]

Other commentators stated that there are relatively limited instances in which resource extraction issuers make payments to governments at the entity level (for example, the payment of corporate income taxes), and that fact should have no bearing on the definition of "project."[285] Those commentators noted that issuers could be permitted to report at the entity level those payments that are levied at the entity level that are not associated with a specific project.

Several commentators suggested defining the term in relation to a particular geologic resource. For example, "project" could be defined to mean technical and commercial activities carried out within a particular geologic basin or province to explore for, develop, and produce oil, natural gas, or minerals.[286] Two commentators further suggested that the definition could specify the covered activities to include acreage acquisition, exploration

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284 Letter from NMA 2. In this regard, we note that the European Commission proposed disclosure requirements that would require companies that are registered or listed in the European Union to report payments to governments on a country and project basis where those payments had been attributed to a specific project. The reporting on a project basis would be made on the basis of companies' current reporting structures. See Proposal for Directive on transparency requirements for listed companies and proposals on country by country reporting – frequently asked questions, COM (2011) MEMO/11/734 (October 25, 2011), available at http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/734&format=HTML&aged=0. As noted above, the proposals are currently pending.

285 See letters from Global Witness 1 and PWYP 1 (stating that a limited disclosure accommodation could be given in the relatively few instances that payments are made at the entity level). See also letter from Calvert (define "project" at the lease or license level except where payments originate at the entity level).

286 See letters from API 1, API 3, Chairman Bachus, BP 1, Chamber Energy Institute, Chevron, ExxonMobil 1, IAOGP, Sen. Murkowski and Sen. Cornyn, Statoil, and USCIB.

studies, seismic data acquisition, exploration drilling, reservoir engineering studies, facilities engineering design studies, commercial evaluation studies, development drilling, facilities construction, production operations, and abandonment.[287] The definition could further state that a project may consist of multiple phases or stages.[288]

Other commentators, however, opposed a definition of "project" based on a particular geologic basin or province.[289] Those commentators maintained that, because multiple companies often conduct activities in a single geologic basin, and because a basin may span more than one country, such a definition would be counter to the "company-by-company" and "country-by-country" reporting requirements of Section 13(q) and would be of limited use to citizens and investors. Commentators further stated that a definition of "project" based on a particular geologic basin would have no relation to the level at which royalty rates, tax payments, and other rights and fiscal obligations are assigned.[290]

Some commentators supported defining "project" to mean a material project,[291] while others opposed such a definition.[292] The commentators that supported defining the term to be

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287 See letters from API 1 and ExxonMobil 1.

288 See letters from API 1 and ExxonMobil 1.

289 See, e.g., letters from ERI 3, Gates Foundation, Oxfam (February 6, 2012) ("Oxfam 2"), Petition from Angolan citizens and Angolan civil society organizations (March 13, 2012) ("Angolan citizens"), Rep. Frank et al., and Soros 2.

290 See, e.g., letters from Gates Foundation, Oxfam 2, and Rep. Frank et al.

291 See letters from API 1, API 2, API 3, Chamber Energy Institute, Chevron, Cravath et al. pre-proposal, ExxonMobil 1, IAOGP, PetroChina, RDS 1, Sen. Murkowski and Sen. Cornyn, and Statoil.

292 See letters from Global Witness 1, Oxfam 1, PWYP 1, and ERI 2. Oxfam and PWYP stated that should the Commission define "project" as a material project, it should clarify that, when determining the materiality of a project, consideration should be given to the significance of a project to a country

a material project asserted that doing so would enable issuers to rely on traditional principles of materiality when determining what constitutes a project.[293] One commentator stated that materiality "should be determined with reference to the issuer's total worldwide government payments and other qualitative factors."[294] Commentators that opposed defining "project" as a material project stated that such a definition is not supported by the plain language of Section 13(q) and would result in inconsistent disclosures.[295]

Several commentators urged the Commission to adopt a definition of "project" in relation to each lease, license, or other concession-level arrangement entered into by a resource extraction issuer.[296] In particular, one commentator urged us to adopt a definition of "project" as "any oil, natural gas or mineral exploration, development, production, transport,

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and its citizens in addition to its significance to an issuer. According to PWYP, "[t]he disclosure of projects that are material to the country would allow comparability across projects and meet the intent of the statute to provide information of use to hold governments accountable."

293 See letters from API 1, Chamber Energy Institute, Chevron, ExxonMobil 1, IAOGP, PetroChina, RDS 1, and Statoil.

294 Letter from API 1.

295 See letters from Global Witness 1, Oxfam 1, and PWYP 1.

296 See letters from Angolan citizens, BTAP, California Public Employees Retirement System (February 28, 2011) ("CalPERS"), Calvert, Cambodians, Derecho, Earthworks, ERI 2, Gates Foundation, Global Financial 2, Global Witness 1, Global Witness 2, Global Witness 3, Greenpeace, Grupo Faro, Guatemalan Forest Communities, Libyan Transparency, Arlene McCarthy, Member of the European Parliament (March 13, 2012) ("McCarthy"), NUPENG, Office of Natural Resources Revenue, US Department of the Interior (August 4, 2011) ("ONRR"), ONE, ONE Petition, Oxfam 1, Oxfam 2, PENGASSAN, PWYP pre-proposal, PWYP 1, PWYP (December 20, 2011) (nine page letter plus appendix) ("PWYP 4"), PWYP (February 23, 2012) ("PWYP 5"), Rep. Frank et al., RWI 1, Revenue Watch Institute (February 27, 2012) ("RWI 2"), Sen. Cardin et al. 1, Soros 2, Syena, TIAA, and WACAM. See also letters designated as Type B (stating that a project should be "defined as our Interior Department does it"). But see the letter from King & Spalding LLP (September 8, 2011) ("King & Spalding") (objecting to ONRR's request for lease by lease payment disclosure because such a disclosure requirement would conflict with ONRR's duty under the Outer Continental Shelf Lands Act to protect the confidentiality of lease-level oil and gas exploration and production information submitted to the agency by a company operating under a federal lease or permit).

refining or marketing activity from which payments above the de minimis threshold originate at the lease or license level, except where these payments originate from the entity level."[297] The commentators supporting a definition of "project" in relation to a lease or license asserted that such an approach would be appropriate because they believed the intent of Section 13(q) was to go beyond the EITI standards, and it would enable investors and others to evaluate the risks faced by issuers operating in resource-rich countries.[298]

According to some commentators, concerns expressed about compliance costs associated with project-level reporting "inflate their likely impact" because most issuers already have internal systems in place for recording payments that would be required to be disclosed under Section 13(q) and many issuers already report payments at the project level or are moving towards project-level disclosure.[299] Another commentator stated that project-level disclosure "would have an extremely beneficial impact on improving investment risk assessment and would provide further levels of corporate and sovereign accountability."[300] That commentator further suggested that consistently applying the rules to all resource extraction issuers would diminish anti-competitive concerns.[301]

### c. Final Rules

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297 Letter from Calvert.

298 See, e.g., letters from CRS, Global Witness 1, Oxfam 1, PWYP 1, and RWI 1.

299 Letter from RWI 1; see also letters from PWYP 1 and ERI 2.

300 Letter from Syena.

301 See id.

After carefully considering the comments, we have determined, consistent with the proposal, to leave the term "project" undefined in the final rules. We continue to believe that not adopting a definition of "project" has the benefit of giving issuers flexibility in applying the term to different business contexts depending on factors such as the particular industry or business in which the issuer operates, or the issuer's size. As noted above, neither Section 13(q) nor our rules include a definition of "project," and the EITI does not define the term. In view of concerns expressed by some commentators with regard to leaving the term undefined,[302] we are providing some guidance about the meaning of the term.

We understand that the term "project" is used within the extractive industry in a variety of contexts. While there does not appear to be a single agreed-upon application in the industry, we note that individual issuers routinely provide disclosure about their own projects in their Exchange Act reports and other public statements, and as such, we believe "project" is a commonly used term whose meaning is generally understood by resource extraction issuers and investors. In this regard, we note that resource extraction issuers routinely enter into contractual arrangements with governments for the purpose of commercial development of oil, natural gas, or minerals. The contract defines the relationship and payment flows between the resource extraction issuer and the government,[303] and therefore, we believe it generally provides a basis for determining the payments, and required payment disclosure, that would be associated with a particular "project."

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302 See note 275 and accompanying text.

303 See letter from TIAA (stating that "disclosure requirements should shed light on the financial relationship between companies and host governments by linking the definition of "project" to the individual contracts between the issuer and host country").

We considered defining "project" by reference to a materiality standard as it is used under the federal securities laws, as suggested by some commentators.[304] We recognize that such an approach may reduce compliance burdens for issuers; however, we believe that approach would be inconsistent with Congress' intent to provide more detailed disclosure than would be provided using such a materiality standard and would not result in the transparency benefits that the statute seeks to achieve. In addition, based on Congress' use of the terms "de minimis" and "material" in other provisions of Section 13(q), we believe that if it intended to limit the disclosure requirement to "material projects" it would have drafted the statutory language accordingly.

While we considered defining the term as a reporting unit[305] as suggested by some commentators,[306] we have decided against that approach. We appreciate the potential benefits to issuers from defining the term consistent with reporting unit and thereby allowing issuers to collect information on a basis with which they already are familiar and according to established financial reporting systems.[307] We also appreciate the concerns some commentators expressed regarding the need to disaggregate and allocate payments in a potentially arbitrary manner, which could increase costs and not provide meaningful

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304 See note 291 and accompanying text.

305 Accounting Standards Code ("ASC") 350-20-20 defines a reporting unit as an operating segment, or a segment that is one level below an operating segment.

306 See note 283 and accompanying text.

307 See note 284 and accompanying text.

information to investors.[308] Nonetheless, for the same reasons we declined to provide a definition of "project" based on materiality, we do not believe that requiring disclosure at the reporting unit level would be consistent with the use of the term "project" in Section 13(q). We also do not believe that a plain reading of the statutory language and the common use of the term "project" would lead one to think that a reporting unit would be a project. Based on Congress' intention to promote international transparency efforts, we believe that Congress intended a greater level of transparency than would be achieved if we defined "project" as a reporting unit.

We also appreciate the concerns some commentators expressed regarding potential definitions of "project" and the need to disaggregate and allocate payments made at the entity level in a potentially arbitrary manner, which could increase costs and would not provide meaningful information to investors.[309] We do not believe that resource extraction issuers should be required to disaggregate and allocate payments to projects for payments that are made for obligations levied on the issuer at the entity level rather than the project level. Consistent with the suggestion of some commentators,[310] the final rules we are adopting will permit a resource extraction issuer to disclose payments at the entity level if the payment is made for obligations levied on the issuer at the entity level rather than the project level.[311] Thus, if an issuer has more than one project in a host country, and that country's government

[308] See, e.g., letters from API 1 and NMA 2.

[309] See, e.g., letters from API 1, Muris and Sayyed, and NMA 2.

[310] See note 285 and accompanying text.

[311] See Instruction 2 to Item 2.01 of Form SD.

levies corporate income taxes on the issuer with respect to the issuer's income in the country as a whole, and not with respect to a particular project or operation within the country, the issuer would be permitted to disclose the resulting income tax payment or payments without specifying a particular project associated with the payment.[312]

We believe the term "project" requires more granular disclosure than country-level reporting. Section 13(q) clearly requires project-level reporting, and we believe the statutory requirement to provide interactive data tags identifying the government that received the payment and the country in which that government is located is further evidence that reference to "project" was intended to elicit disclosure at a more granular level than country-level reporting.[313]

#### 4. Payments by "a Subsidiary...or an Entity Under the Control of..."

##### a. Proposed Rules

Consistent with Section 13(q),[314] the proposed rules would have required a resource extraction issuer to disclose payments made by the issuer, a subsidiary, or an entity under the control of the resource extraction issuer, to a foreign government or the U.S. Federal Government for the purpose of commercial development of oil, natural gas, or minerals. Under the proposal, and consistent with Section 13(q), a resource extraction issuer would have been required to provide disclosure if control is present. Consistent with the definition

312 One commentator provided, as an example, a situation where the payment of corporate income taxes is calculated on the basis of all projects in a given jurisdiction. See letter from Global Witness 1.

313 See 15 U.S.C. 78m(q)(2)(D)(ii)(V).

314 See 15 U.S.C. 78m(q)(2)(A).

of control under the federal securities laws,[315] a resource extraction issuer would have been required to make a factual determination as to whether it has control of an entity based on a consideration of all relevant facts and circumstances. At a minimum, a resource extraction issuer would have been required to disclose payments made by a subsidiary or entity under the issuer's control if the issuer must provide consolidated financial information for the subsidiary or other entity in the issuer's financial statements included in its Exchange Act reports.

### b. Comments on the Proposed Rules

Several commentators stated that we should rely on the current definitions of "control" and "subsidiary" under Exchange Act Rule 12b-2,[316] or as those terms are used under U.S. GAAP or IFRS, and we need not adopt new definitions of those terms for purposes of this rulemaking because the current definitions are well-understood by both extractive issuers and investors.[317] When applying those definitions, however, commentators held a variety of views regarding the entities for which resource extraction issuers should be required to provide the required payment information.

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315 Under Exchange Act Rule 12b-2 [17 CFR 240.12b-2] and Rule 1.02 of Regulation S-X [17 CFR 210.1.02], "control" (including the terms "controlling," "controlled by" and "under common control with") is defined to mean "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise." The rules also define "subsidiary" ("A 'subsidiary' of a specified person is an affiliate controlled by such person directly, or indirectly through one or more intermediaries. (See also 'majority-owned subsidiary,' 'significant subsidiary,' and 'totally-held subsidiary.')").

316 See id.

317 See letters from API 1, AngloGold, BP 1, ERI 1, ExxonMobil 1, PWC, and RDS 1.

Some commentators believed that whether an issuer has control over an entity is consistent with whether it must consolidate that entity for purposes of the issuer's financial reporting. Those commentators suggested the rules should only require an issuer to report payments for an entity that it must either fully or proportionately consolidate for U.S. financial reporting purposes and not require disclosure of payments of equity investees for which no consolidation is required.[318] Some commentators further stated that an issuer should not have to report payments corresponding to its proportional interest in a joint venture unless it makes such payments directly to the host government.[319] The commentators noted that, under such an approach, proportional payments made to the joint venture operator would not be reported.[320]

One commentator supported requiring an issuer to disclose payments only for entities that it must consolidate because that approach would provide a bright-line test that is easy to administer and because it would be consistent with the EITI.[321] The commentator further stated that an issuer should be required to disclose payments made on behalf of a joint

318 See letters from API 1, BP 1, ExxonMobil 1, and RDS 1. Other commentators agreed that the final rules should define control to mean consolidated entities only but opposed using the definition of control under Exchange Act Rule 12b-2 on the grounds that the existing definition could include companies that are not consolidated and regarding which an issuer would lack access to the underlying accounting data for the controlled entities' payments. See letters from Barrick Gold, Cleary, GE, NMA 2, NYSBA Committee, Petrobras, Rio Tinto, and Statoil. One commentator further observed that restricting the definition of control to consolidated entities would avoid the possible overstating of resource extraction payments that might occur if payments by equity investees are required to be disclosed. See letter from Rio Tinto.

319 See letters from API 1, ExxonMobil 1, and RDS 1.

320 See id.

321 See letter from AngloGold.

venture, regardless of control, when the payments are disproportionate to the issuer's interest in the joint venture.[322]

Other commentators believed that, in addition to requiring disclosure of payments made by consolidated entities, the rules also should require disclosure of payments:

- made by or on behalf of unconsolidated equity investees and joint venture partners on a proportionate share basis where a facts and circumstances test determines that the issuer possesses control;[323]
- made by the issuer's non-reporting parent or other related entity on behalf or for the benefit of the issuer when the issuer is the alter ego or instrumentality of the parent or related entity[324] or when the issuer "controls, is controlled by, or is under common control with" the non-reporting parent or related entity, and the subsidiary would otherwise be required to disclose those payments under Section 13(q);[325]

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322 See letter from AngloGold. This commentator provided an example in which an issuer that is a 50% partner in a joint venture would have to disclose payments made on behalf of that joint venture if the payments include the share attributable to the other joint venture partner in circumstances where the other partner is unwilling or unable to make its share of the payments.

323 See letters from Earthworks and PWYP 1.

324 See letter from Conflict Risk Network (February 28, 2011) ("Conflict Risk").

325 See letters from HURFOM 1, PWYP 1, and WRI.

- made by an entity that is contractually obligated to collect funds and make payments to various parties, including the host government, on behalf of an issuer;[326] and
- made by one party to a joint venture that has guaranteed the debt of another joint venture party in an off-balance sheet transaction.[327]

Some commentators believed that a foreign government-owned or controlled entity should not have to report certain payments made to its parent government[328] or to a subsidiary or other entity controlled by it.[329] Another commentator stated that a wholly-owned subsidiary of an Exchange Act reporting parent should not have to disclose payments as long as the subsidiary's parent has included the subsidiary's payments in the parent's Exchange Act report.[330]

#### c. Final Rules

We are adopting this requirement as proposed, consistent with the statutory language of Section 13(q). The final rules require a resource extraction issuer to provide disclosure of payments made by the issuer, a subsidiary of the issuer, or an entity under the control of the issuer to a foreign government or the U.S. Federal Government for the purpose of the

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326 See letters from ERI pre-proposal and Le Billon.

327 See id.

328 See letter from Cleary.

329 See letter from Statoil.

330 See letter from API 1.

commercial development of oil, natural gas, or minerals.[331] "Control" and "subsidiary" are terms defined as in Exchange Act Rule 12b-2.[332] Therefore, a resource extraction issuer must disclose payments made by a subsidiary or entity under the control of the resource extraction issuer where the subsidiary or entity is consolidated in the resource extraction issuer's financial statements included in its Exchange Act reports,[333] as well as payments by other entities it controls as determined in accordance with Rule 12b-2. A resource extraction issuer may be required to provide the disclosure for entities in which it provides proportionately consolidated information.[334]

We understand that resource extraction issuers commonly engage in commercial development of oil, natural gas, or minerals through joint ventures, as an operator of a joint venture, or through an equity investment.[335] In these situations a resource extraction issuer

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331 With respect to payments by an Exchange Act reporting company meeting the definition of resource extraction issuer that also is a wholly-owned subsidiary of an Exchange Act reporting parent that is a resource extraction issuer, consistent with some commentators' suggestions, the subsidiary will not be required to separately disclose payments to governments provided that the subsidiary's parent has included the subsidiary's payments in the parent's Form SD. The subsidiary must file its own Form SD indicating that the required disclosure was provided in the parent's Form SD. See Instruction 8 to Item 2.01 of Form SD.

332 See note 315 above.

333 This would be the case whether the resource extraction issuer provides consolidated financial information under U.S. Generally Accepted Accounting Principles ("GAAP"), International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS"), or another comprehensive basis of accounting other than U.S. GAAP or IFRS.

334 Proportionate consolidation may be used in a variety of circumstances in which an issuer may or may not have control, and therefore resource extraction issuers will need to make a facts-and-circumstances determination, as discussed below.

335 See, e.g., letters from API 1, ERI pre-proposal, NMA 2, and PWYP 1. See also Ernst & Young, Navigating Joint Ventures in the Oil and Gas Industry (2011), available at http://www.ey.com/Publication/vwLUAssets/Navigating_joint_ventures_in_oil_and_gas_industry/$FILE/Navigating_joint_ventures_in_oil_and_gas_industry.pdf.

will be required to determine whether it has control of an entity based on a consideration of all relevant facts and circumstances.[336] Following the definition of control under the federal securities laws, such as in Rule 12b-2, a resource extraction issuer will be required to determine whether it has control of an entity for purposes of Rule 13q-1 based on a consideration of all relevant facts and circumstances.[337] We continue to believe that a facts-and-circumstances determination of control consistent with the federal securities laws is preferable to a bright-line rule limiting disclosure to payments made only by consolidated entities because it is consistent with the statutory language. Limiting the scope of the requirement to situations in which an issuer provides consolidated financial information for an entity may limit the rules more narrowly than the intended scope of the statute because a resource extraction issuer may have control over an unconsolidated entity that makes payments that would be covered by Section 13(q) and the final rules. Thus, an issuer that engages in joint ventures or contractual arrangements will need to consider whether it has control to determine whether it must disclose payments.

We disagree with commentators who suggested that the definition of "control" not track Rule 12b-2 and instead be entirely consistent with the use of the term for purposes of financial reporting. While determinations made pursuant to the relevant accounting

336 As we noted in the Proposing Release, if a resource extraction issuer makes a payment to a third party to be paid to the government on its behalf, the rules will require disclosure of that payment. Similarly, where an entity makes payments (that are otherwise covered by the definition of payment) to a foreign government as a paying agent for a resource extraction issuer, pursuant to a contractual obligation with the resource extraction issuer, the final rules require the resource extraction issuer to disclose these payments.

337 We expect that a determination in accordance with consolidation guidance generally would be the same as under Rule 12b-2.

standards applicable for financial reporting may be indicative of whether control exists, we do not believe it is determinative in all cases. We note the suggestion by some commentators to adopt a definition of control that does not track Rule 12b-2 and specifically addresses unconsolidated equity investees.[338] We are not adopting such a definition because we believe it is appropriate and consistent with the statute to use the same definition of control used for other purposes under the Exchange Act, and because issuers should already be familiar with applying that definition. A resource extraction issuer is required to make a facts-and-circumstances determination as to whether the equity investee is an entity under the control of the resource extraction issuer under the final rules.

## E. Definition of "foreign government"

### 1. Proposed Rules

Consistent with Section 13(q), the proposed rules would have required a resource extraction issuer to disclose payments made to a foreign government or the Federal Government. Under Section 13(q), Congress defined "foreign government" to mean a foreign government, a department, agency, or instrumentality of a foreign government, or a company owned by a foreign government, while granting the Commission authority to determine the scope of the definition.[339] The proposed rules would have defined the term consistent with the statute. In addition, the proposed definition of "foreign government" explicitly included both a foreign national government as well as a foreign subnational

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338 See letters from Earthworks and PWYP 1.

339 See 15 U.S.C. 78m(q)(1)(B).

government, such as the government of a state, province, county, district, municipality, or territory under a foreign national government. The proposed rules would have clarified that the term "Federal Government" means the United States Federal Government. The proposed rules would have further clarified that a company owned by a foreign government is a company that is at least majority-owned by a foreign government.

### 2. Comments on the Proposed Rules

Commentators generally supported the proposed definition of foreign government.[340] Some of those commentators noted that inclusion of foreign subnational governments is appropriate because issuers frequently make payments to subnational governments and that including them would be consistent with the EITI.[341] Some commentators also supported the proposed clarification regarding the meaning of "Federal Government"[342] and agreed that the term did not include state governments.[343] Those commentators believed that extending the disclosure requirement to states and other subnational governments in the United States would go beyond the scope of the statute. A few commentators explicitly supported the proposed clarification regarding the meaning of "a company owned by a foreign government."[344]

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340 See letters from API 1, AngloGold, Barrick Gold, BP 1, Calvert, CRS, Earthworks, EIWG, ExxonMobil 1, PWYP 1, RDS 1, and WRI.

341 See letters from API 1, AngloGold, Barrick Gold, BP 1, Calvert, CRS, Earthworks, EIWG, ExxonMobil 1, PWYP 1, RDS 1, and WRI.

342 See letters from API 1, BP 1, Calvert, ExxonMobil 1, NYSBA Committee, and RDS 1.

343 See letters from API 1, BP 1, Calvert, ExxonMobil 1, NYSBA Committee, and RDS 1.

344 See letters from API 1, ExxonMobil 1, and PetroChina.

Some commentators, however, suggested alternative approaches to the definition of foreign government.[345] A few commentators supported adopting the statutory definition of "foreign government" and suggested limiting the rule to require resource extraction issuers to disclose only those payments made to foreign national governments. According to those commentators, it would be unfair to require disclosure of payments to foreign subnational governments because Section 13(q) does not require disclosure of payments to subnational governments in the United States. Thus, limiting the requirement to disclose payments only to foreign national governments would promote consistency and fairness.[346] One commentator stated that defining "foreign government" to mean only a foreign national government would be consistent with the plain meaning of Section 13(q).[347] According to that commentator, the fact that the statute requires an issuer to include electronic tags identifying both the recipient government for each payment and the country in which that government is located does not mean that Congress intended to include foreign subnational governments within the definition of foreign government. Rather, according to that commentator, because the statutory definition of foreign government includes departments, agencies and instrumentalities of a foreign government, Congress intended only that an issuer would use the recipient government tag to identify the specific department, agency or instrumentality receiving the payment. In addition, one commentator noted that it has a substantial number of provincial government leases and that it would be overburdened by

345 See, e.g., letters from NMA 2, Statoil, and Talisman.

346 See letters from NMA 2, Statoil, and Talisman.

347 See letter from Statoil.

reporting payments on a subnational level.[348] A few commentators supported adoption of the proposed definition of "foreign government" and also suggested requiring the disclosure of payments made to U.S. subnational governments because extractive companies may make substantial payments to U.S. subnational governments.[349]

Some commentators requested the Commission clarify that whether an issuer will be required to disclose payments made to a foreign government-owned company would depend on whether the foreign government controls that company.[350] One of those commentators suggested that whether control exists should be determined by a facts-and-circumstances analysis, which could result in the conclusion that a non-majority owned company is controlled by a foreign government.[351] The commentator believed the analysis should consider whether the government has provided working capital to the company, and whether the government has the ability to direct economic or policy decisions of the company, appoint or remove directors or management, restrict the composition of the board, or veto the decisions of the company.[352] The other commentator suggested we also "[should] look at the extent to which the government has control over the company and also the extent of advances and payments by the company to the government."[353]

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348 See letter from Talisman.

349 See letters from AngloGold, Barrick Gold, and Earthworks.

350 See letters from PetroChina and PWYP 1.

351 See letter from PWYP 1.

352 See letter from PWYP 1.

353 See letter from PetroChina.

Other commentators suggested that the Commission clarify whether an issuer will be required to disclose payments made to a foreign government-owned company would depend on the capacity in which the company is acting.[354] According to the commentators, if the government-owned company is acting as the agent of the government, the issuer should have to disclose payments made to the government-owned company.[355] If the government-owned company is acting in the capacity of a commercial partner with the issuer, and the government-owned company is the operator of the joint venture, the issuer should not have to disclose payments "for capital or operating cash calls" made to the government-owned company.[356] Two commentators asserted that an issuer also should not have to disclose payments to a government-owned company acting in the capacity of a commercial vendor of goods and services.[357] Other commentators believed that Section 13(q) requires the disclosure of all payments to a government or government-owned company whether for "rent, security, food and water, use of roads and airports" or for capital contributions.[358]

### 3. Final Rules

After considering the comments, we are adopting the definition of "foreign government" consistent with the definition in Section 13(q), as proposed. A "foreign government" includes a foreign national government as well as a foreign subnational

354 See letters from API 1, Cleary, ExxonMobil 1, and Vale.

355 See letters from API 1 and ExxonMobil 1.

356 See letters from API 1 and ExxonMobil 1.

357 See letters from Cleary and Vale.

358 See letters from PWYP 1 and Sen. Levin 1.

government, such as the government of a state, province, county, district, municipality, or territory under a foreign national government.[359] Although we acknowledge the concerns of commentators that sought to limit the definition of foreign government to foreign national governments,[360] we continue to believe that the definition also should include foreign subnational governments. The adopted definition is not only consistent with Section 13(q), which requires an issuer to identify, for each disclosed payment, the government that received the payment, and the country in which the government is located,[361] but it also is consistent with the EITI, which recognizes that payments to subnational governments may have to be included within the scope of an EITI program.[362] As noted in the proposal, if a resource extraction issuer makes a payment that meets the definition of payment to a third party to be paid to the government on its behalf, disclosure of that payment is covered under the rules.

In addition, as proposed, the final rules clarify that a company owned by a foreign government is a company that is at least majority-owned by a foreign government.[363] As noted above, some commentators requested that we clarify the circumstances in which an issuer will be required to disclose payments made to a foreign government-owned company. The final rules specify the types of payments that will be required to be disclosed, and

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359 See Item 2.01(c)(2) of Form SD.

360 See, e.g., letter from Statoil.

361 See 15 U.S.C. 78m(q)(2)(D)(ii)(V).

362 See Implementing the EITI, at 34.

363 See Instruction 4 to Item 2.01 of Form SD.

resource extraction issuers will need to consider whether the payments being made to a foreign government-owned company fall within the categories of payments for which the final rules require disclosure.

As proposed, the final rules clarify that "Federal Government" means the United States Federal Government.[364] Although we acknowledge that there is a difference in the final rules between requiring disclosure of payments to foreign subnational governments and not requiring payments to state or local governments in the United States, we believe that Section 13(q) is clear in only requiring disclosure of payments made to the Federal Government in the United States and not to state and local governments. As we noted in the proposal, typically the term "Federal Government" refers only to the U.S. national government and not the states or other subnational governments in the United States.

[364] See Item 2.01(a) of Form SD.

### F. Disclosure Required and Form of Disclosure

#### 1. Annual Report Requirement

##### a. Proposed Rules

As noted in the proposal, Section 13(q) mandates that a resource extraction issuer provide the payment disclosure required by that section in an annual report, but otherwise does not specify the location of the disclosure, either in terms of a specific form or in terms of location within a specific form. The proposed rules would have required a resource extraction issuer to provide the payment disclosure in exhibits to its Exchange Act annual report filed on Form 10-K, Form 20-F, or Form 40-F. In addition, the proposed rules would have required a resource extraction issuer to include a brief statement in the body of the annual report directing investors to detailed information about payments provided in the exhibits.

##### b. Comments on Proposed Rules

Some commentators supported the proposed approach,[365] while other commentators opposed requiring the disclosure in Exchange Act annual reports on Form 10-K, Form 20-F, and Form 40-F and suggested alternative approaches.[366]

Commentators asserted that it would be difficult to provide the payment disclosure, which could be voluminous, within the same time period for Exchange Act annual reports. Those commentators maintained that additional time is necessary to provide the required

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365 See letters from Calvert, Earthworks, HURFOM 1, ONE, PGGM, PWYP 1, RWI 1, and Soros 1.

366 See, e.g., letters from API 1, AngloGold, Barrick Gold, BP 1, Chevron, Cleary, ExxonMobil 1, NMA 2, NYSBA Committee, Nexen, PetroChina, Petrobras, RDS 1, and Statoil.

information.[367] Otherwise, according to commentators, due to resource constraints, issuers may be unable to file their Exchange Act annual reports on a timely basis if they are required to provide the new payment disclosure at the same time that they must meet their existing obligations with respect to Exchange Act annual reports.[368] Commentators further maintained that the payment disclosures are largely cash-based, unaudited, of little relevance to most financial statement users, and should not be subject to certification requirements, whereas the financial statement information in an existing Exchange Act annual report is accrual-based, audited, of primary importance to most financial statement users, and subject to certification requirements.[369] Those commentators believed that keeping the payment disclosure separate from the financial statements and corresponding disclosure would avoid confusion.

Many commentators supported requiring a resource extraction issuer to make the payment disclosure in a new annual report form or under cover of a Form 8-K or Form 6-K, rather than in an existing Exchange Act annual report.[370] Some commentators supported using only Forms 8-K or 6-K,[371] while other commentators favored using only a new annual

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367 See letters from API 1, AngloGold, Barrick Gold, BP 1, Cleary, ExxonMobil 1, NMA 2, NYSBA Committee, Nexen, Petrobras, and RDS 1.

368 See letter from Cleary; see also letters from Barrick Gold and Petrobras.

369 See letters from API 1, AngloGold, Barrick Gold, Cleary, ExxonMobil 1, NMA 2, and NYSBA Committee.

370 See letters from API 1, Barrick Gold, Chevron, Cleary, ExxonMobil 1, NYSBA Committee, and RDS 1.

371 See letters from AngloGold, Nexen, PetroChina, and Petrobras.

report.[372] One commentator opposed using Form 8-K for the Section 13(q) disclosure because Form 8-K is the "venue for time-sensitive disclosures of unique changes to a company" whereas, according to that commentator, the Section 13(q) disclosure consists of "standard, material financial disclosures that should be included in the primary documents filed in the Exchange Act annual report."[373]

Some commentators supporting a new annual report form believed the potential benefits of providing the disclosure on a new form rather than in an Exchange Act annual report outweighed the potential costs associated with the new form.[374] Commentators suggested that the required disclosure could be due 150 or 180 days or some other lengthy period following the end of the issuer's fiscal year.[375] Two commentators believed that the reporting period for the resource extraction issuer disclosure should be the calendar year as opposed to the fiscal year as is the case for existing Exchange Act annual reports because the calendar year approach would facilitate review and compilation by the Commission and analysis by users.[376] Other commentators, however, suggested that disclosure should be required for the issuer's fiscal year.[377]

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372 See letters from NMA 2 and Statoil.

373 Letter from Calvert.

374 See letters from API 1 and Cleary.

375 See letters from API 1, AngloGold, Barrick Gold, BP 1, Chevron, Cleary, ExxonMobil 1, NMA 2, NYSBA Committee, Nexen (supporting 180 days), PetroChina, Petrobras, RDS 1 (supporting 150 days), and Statoil.

376 See letters from API 1 and ExxonMobil 1.

377 See letters from AngloGold and RDS 1.

Several commentators that supported a deadline for the disclosure separate from the due date for the Exchange Act annual report opposed allowing the disclosure to be provided in an amendment to the Form 10-K, Form 20-F, and Form 40-F.[378] According to those commentators, such an amendment could be misconstrued as a correction of an error or omission or as a restatement.[379] Other commentators stated that if the Commission decides to require inclusion of the disclosure in an Exchange Act annual report, it would be reasonable to permit an issuer to disclose the information in an amendment to the annual report.[380]

Some commentators suggested permitting issuers to submit the payment disclosure on a confidential basis.[381] These commentators stated that the Commission could then use the confidentially submitted information to prepare a public compilation, which would consist of information only at the country or other highly aggregated level. The commentators asserted that Section 13(q)(3), which is entitled "Public Availability of Information," requires the Commission to make public a compilation of the information required to be submitted under Section 13(q)(2). According to the commentators, the statute does not require the submitted information itself to be publicly available.[382] Commentators argued that the payment

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378 See letters from API 1, AngloGold, ExxonMobil 1, NMA 2, and RDS 1.

379 See id.

380 See letters from Cleary, NMA 2, and NYSBA Committee. Cleary and NYSBA Committee supported this approach if the Commission decided not to require the disclosure in a new annual report form or under cover of Form 8-K or 6-K.

381 See letters from API 1, Chevron, ExxonMobil 1, Nexen, and RDS 1.

382 See letters from API 1, Chevron, ExxonMobil 1, Nexen, and RDS 1.

information should be submitted confidentially at a disaggregated level and that the public compilation by the Commission could be presented on "an aggregated, per-country or similarly high-level basis."[383] According to those commentators, this approach would satisfy the specific text of the statute and fulfill the underlying goal of promoting the international transparency regime of the EITI.[384]

In contrast, other commentators strongly disagreed with the interpretation that Section 13(q) should be read as to not require the public disclosure of the payment information submitted in annual reports and that the Commission may choose to make public only a compilation of the information.[385] One commentator stated that the "compilation would be in addition to the public availability of the original company data and in no way is expected to replace the availability of that data."[386] Two commentators supporting the proposed approach requested that the Commission clarify that the statutorily-required compilation would function both as an online database and summary report, which would allow users to download data in bulk, in addition to allowing users to search by country and company, as well as by year or multiple years of reporting.[387]

Two commentators stated that, to the extent the new rules require the payment disclosure to be in an existing Exchange Act annual report, the rules should provide that the

383 See letters from API 1 and ExxonMobil 1. See also letters from Chevron, Nexen, and RDS 1.

384 See letters from API 1 and ExxonMobil 1. See also letters from Chevron and RDS 1.

385 See letters from Calvert, PWYP 1, RWI 1, Sen. Cardin et al. 1, Sen. Cardin et al. 2, and Sen. Levin 1.

386 Letter from Sen. Cardin et al. 1.

387 See letters from PWYP 1 and USW.

officer certifications required by Exchange Act Rules 13a-14(a) and (b) and 15d-14(a) and (b) do not extend to exhibits or disclosures required pursuant to Section 13(q).[388]

### c. Final Rules

After considering the comments, we have determined that resource extraction issuers should provide the required disclosure about payments in a new annual report, separate from the issuer's existing Exchange Act annual report. We are requiring the disclosure on new Form SD.[389] As noted above, Section 13(q) does not specify a location for the disclosure. We believe requiring resource extraction issuers to provide the payment disclosure in new Form SD will facilitate interested parties' ability to locate the disclosure and address issuers' concerns about providing the disclosure in their Exchange Act annual reports on Forms 10-K, 20-F, or 40-F.[390] Similar to the proposal, Form SD requires issuers to include a brief statement in the body of the form in an item entitled, "Disclosure of Payments By Resource

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[388] See letters from Cleary and NYSBA Committee.

[389] Form SD is a new disclosure form to be used for specialized disclosure not included within an issuer's periodic or current reports. In addition to resource extraction issuer payment disclosure, Form SD also will be used to provide the disclosure required by the rules implementing Section 1502 of the Dodd-Frank Act. The Commission adopted Form SD at the same time as the final rules implementing that provision. See Conflict Minerals Adopting Release.

[390] See notes 366-370 and accompanying text. As noted, under the proposed rules, a resource extraction issuer would have been required to furnish the payment information in its annual report on Form 10-K, Form 20-F, or Form 40-F. As such, investment companies that are registered under the Investment Company Act of 1940 ("registered investment companies") would not have been subject to the disclosure requirement because those companies are not required to file Form 10-K, Form 20-F, or Form 40-F. Our decision to require this disclosure in a new form is not intended to change the scope of companies subject to the disclosure requirement. Therefore, consistent with the proposal, registered investment companies that are required to file reports on Form N-CSR or Form N-SAR pursuant to Rule 30d-1 under the Investment Company Act (17 CFR 270.30d-1) will not be subject to the final rules.

Extraction Issuers," directing investors to the detailed payment information provided in the exhibits to the form.

We considered commentators' suggestions about requiring the disclosure in a Form 8-K or Form 6-K,[391] and we determined not to require the disclosure in those forms because we continue to believe, and agree with commentators that noted, the resource extraction payment disclosure differs from the disclosure required by those forms.[392] In this regard, we note that Section 13(q) requires us to issue final rules requiring the disclosure in an annual report rather than requiring the disclosure to be provided on a more rapid basis, such as disclosure of material corporate events that are required to be filed on a current basis on Form 8-K.[393] In addition, we are persuaded by the comments asserting that it would be preferable to use a different form rather than to extend the deadline for the disclosure to be filed and require an amendment to Form 10-K, Form 20-F, or Form 40-F, which might suggest a change or correction had been made to a previous filing,[394] and therefore we are not adopting that approach. We also believe that requiring the disclosure in a new form, rather than in issuers' Exchange Act annual reports, should alleviate some commentators' concerns

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391 See note 371 and accompanying text.

392 See, e.g., letter from Calvert.

393 A Form 8-K report is required to be filed or furnished within four business days after the occurrence of one or more of the events required to be disclosed on the Form, unless the Form specifies a different deadline, e.g., for disclosures submitted to satisfy obligations under Regulation FD (17 CFR 243.100 et seq. See General Instruction B.1 of Form 8-K (17 CFR 249.308).

394 See note 379 and accompanying text.

about the disclosure being subject to the officer certifications required by Rules 13a-14 and 15d-14 under the Exchange Act[395] and will allow us to adjust the timing of the submission.

While Section 13(q) mandates that a resource extraction issuer include the payment disclosure required by that section in an annual report, it does not specifically mandate the time period in which a resource extraction issuer must provide the disclosure. Although two commentators believed that the reporting period for the resource extraction disclosure should be the calendar year, other commentators suggested that the fiscal year should be the reporting period for Form SD.[396] We believe that the fiscal year is the more appropriate reporting period for the payment disclosure because, to the extent that resource extraction issuers are able to use part of the tracking and reporting systems that issuers already have established for their public reports to track and report payments under Section 13(q), their compliance costs should be reduced.

After considering the comments expressing concern about the difficulty of providing the payment disclosure within the current annual reporting cycle,[397] we believe it is reasonable to provide a filing deadline for Form SD that is later than the deadline for an issuer's Exchange Act annual report. Therefore, consistent with some commentators' suggestions regarding timing,[398] the final rules require resource extraction issuers to file

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395 See note 369.

396 Compare note 376 with note 377.

397 See note 367 and accompanying text.

398 See notes 375-377 and accompanying text.

Form SD on EDGAR no later than 150 days after the end of the issuer's most recent fiscal year.

We are not persuaded by commentators that the statute allows resource extraction issuers to submit, or that it mandates resource extraction issuers submit, the payment information confidentially to us and have the Commission make public only a compilation of the information.[399] We believe that Section 13(q) contemplates that resource extraction issuers will provide the disclosure publicly. Section 13(q) refers to "disclosure" and specifies that the final rules require an issuer to include the information "in an annual report." Our existing disclosure requirements under the Exchange Act require companies to publicly file annual, quarterly, and current reports; the requirements generally do not provide for non-public reports.[400] We do not believe that Congress intended for a different approach with respect to the information required under Section 13(q). In this regard, we note that the disclosure required under Section 13(q)(2) must be submitted in an interactive data format, which suggests that Congress intended for the information to be available for public analysis. Requiring resource extraction issuers to provide the payment information in interactive data format will enable users of the information to extract the information that is of the most

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399 See note 381 and accompanying text.

400 We note that in certain limited instances, an issuer may request confidential treatment regarding information that otherwise would be required to be disclosed, such as commercial information obtained from a person and that is privileged or confidential. See, e.g., Exchange Act Rule 24b-2 (17 CFR 240.24b-2). For example, an issuer may be permitted to omit certain information from an exhibit filed with an Exchange Act report if that information is commercial and disclosure would likely result in substantial competitive harm. The Commission's staff is of the view that issuers generally are not permitted to omit information that is required by an applicable disclosure requirement. See Division of Corporation Finance Staff Legal Bulletins Nos. 1 (February 28, 1997) and 1A (July 11, 2001, as amended), available at http://www.sec.gov/interps/legal/slbcf1r.htm.

interest to them and to compile and compare it in any manner they find useful. We also note that the provision regarding the public compilation does not require the Commission to publish a compilation; rather, it states that the Commission shall make a public compilation of the information available online "to the extent practicable."[401] Further, Section 13(q)(3)(B) states that "[n]othing in [Section 13(q)(3)] shall require the Commission to make available online information other than the information required to be submitted [under the provision requiring the Commission to issue rules to require resource extraction issuers to provide payment disclosure]." We believe these provisions, when read together and with the statute's transparency goal, mean that the statutory intent is for the disclosure made by resource extraction issuers to be publicly available, and under the final rules, the disclosure will be available on Form SD on EDGAR. We note that, in this regard, the EITI approach is fundamentally different from Section 13(q). Under the EITI, companies and the host country's government generally each submit payment information confidentially to an independent administrator selected by the country's multi-stakeholder group, frequently an independent auditor, who reconciles the information provided by the companies and the government, and then the administrator produces a report.[402] In addition, it is not clear that having the information submitted confidentially to the Commission would necessarily

401 Specifically, Section 13(q)(3)(A) provides that "[t]o the extent practicable, the Commission shall make available online, to the public, a compilation of the information required to be submitted under the rules issued under paragraph (2)(A)."

402 See EITI Source Book, at 23 ("It will be necessary to appoint an administrator to collect and evaluate the revenue data provided by companies and government. It is essential that there is stakeholder trust in the administrator's impartiality and competency. The administrator may be a private audit firm, an individual or an existing or specially created official body that is universally regarded as independent of, and immune to influence by, the government.")

address commentators' concerns about confidentiality because the information may well be subject to disclosure under the Freedom of Information Act.[403]

### 2. Exhibits and Interactive Data Format Requirements

#### a. Proposed Rules

The proposed rules would have required a resource extraction issuer to submit the payment disclosure on an unaudited, cash basis. The disclosure would have been required to be presented in two exhibits to a Form 10-K, Form 20-F, or Form 40-F, as appropriate. One exhibit would be in HTML or ASCII format, which would have enabled investors to easily read the disclosure about payments without additional computer programs or software. The other exhibit would be in XBRL format, which would have satisfied the requirement in Section 13(q) that the payment information be submitted in an interactive data format. Consistent with the statute, the proposed rules would have required an issuer to submit the payment information using electronic tags that identify, for any payments made by a resource extraction issuer to a foreign government or the U.S. Federal Government:

- the total amounts of the payments, by category;
- the currency used to make the payments;
- the financial period in which the payments were made;
- the business segment of the resource extraction issuer that made the payments;
- the government that received the payments, and the country in which the government is located; and

403 5 U.S.C. 552.

- the project of the resource extraction issuer to which the payments relate.

In addition, a resource extraction issuer would have been required to provide the type and total amount of payments made for each project and the type and total amount of payments made to each government in the XBRL format.

As noted above, Section 13(q) requires the Commission, to the extent practicable, to make available online, to the public, a compilation of the information required under paragraph (2)(A) of that section.[404] The statute does not specify the content, form or frequency of the compilation. We solicited comment on the compilation without proposing any specific requirements for it.

#### b. Comments on the Proposed Rules

Numerous commentators supported the proposed submission of the payment information on an unaudited, cash basis.[405] After noting that Section 13(q) neither requires the payment information to be audited nor provided on an accrual basis, those commentators stated that such a requirement would significantly increase issuers' implementation and ongoing reporting costs without providing a benefit to investors. One commentator further

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[404] See Section 13(q)(3)(A). The information required under Section 13(q)(2)(A) includes the type and total amount of payments made by resource extraction issuers to foreign governments or the U.S. Federal Government for the purpose of the commercial development of oil, natural gas, or minerals on a per project and per government basis.

[405] See letters from API 1, Anadarko Petroleum Corporation (March 2, 2011) ("Anadarko"), AngloGold, BP 1, Chevron, Ernst & Young (January 31, 2011) ("E&Y"), ExxonMobil 1, NMA 2, NYSBA Committee, Petrobras, PWC, and RDS 1.

noted that "auditors would have to develop specific additional procedures to be able to provide assurance regarding the completeness and accuracy of the information provided."[406]

Other commentators, however, suggested requiring the payment information to be audited, presented on both a cash and accrual basis, and filed as part of the issuer's audited financial statements.[407] One of the commentators stated that an audit requirement would enhance investor protection and be consistent with the EITI because one of the basic criteria of EITI implementation is that the reported payment data be audited.[408] Another commentator similarly believed that requiring the payment information to be audited and submitted on a cash basis would improve comparability with EITI-related data, which it noted is subject to audit and reported on a cash basis. That commentator further suggested that the payment information also be reported on an accrual basis to accommodate the needs of all potential users of the data.[409]

Several commentators supported the proposed requirement to use XBRL to tag the payment disclosure because XBRL is currently used by many registrants when filing their financial statements in their Exchange Act annual reports.[410] Some commentators further supported a requirement to prepare the payment disclosure in either ASCII or HTML in

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406 Letter from E&Y.

407 See letters from PWYP 1 and RWI 1. Another commentator supported a requirement to submit the payment information solely on an accrual basis because that would be consistent with financial reporting requirements. See letter from Talisman.

408 See letter from RWI 1.

409 See letter from PWYP 1.

410 See letters from API 1, Anadarko, AngloGold, BP 1, CalPERS, ExxonMobil 1, PWYP 1, and RDS 1.

addition to XBRL.[411] Those commentators noted that the requirement would provide the Commission with the ability to extract, analyze, and accumulate XBRL information while also providing investors and others the ability to view directly the information. Several commentators requested that the Commission delay implementation of the tagging requirement until an appropriate XBRL taxonomy for the payment information is available.[412]

Other commentators suggested permitting an issuer to choose between XBRL, XML, or some other format that would enable the electronic tagging of all of the information specified in Section 13(q).[413] According to those commentators, such a flexible approach would recognize that some issuers may prefer to use XBRL because that standard is already being implemented, while others may prefer to use XML or some other format because it is less expensive than XBRL and more consistent with a cash-based report.[414] One of the commentators noted that "XBRL conversion of data can be time consuming and result in delay" and requested that the rules permit an issuer to "use any format that would allow users to click through the information in a standard file type to reach data sorted by each of the electronic tags specified in the Act."[415] One commentator opposed a requirement to provide

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411 See letters from API 1, ExxonMobil 1, and PWYP 1.

412 See letters from API 1, AngloGold, and ExxonMobil 1.

413 See letters from Barrick Gold and NMA 2.

414 See letters from Barrick Gold and NMA 2.

415 Letter from Barrick Gold.

the payment information in XBRL format.[416] The commentator stated that the Commission has limited the implementation of XBRL to only financial statements and stated there was not "any justifiable reason for a departure from this stated scope."[417]

Some commentators expressed views about specific electronic tags. For example, commentators suggested various approaches regarding the requirement to electronically tag information about the currency used to make the payments. Some commentators opposed having to present payment information in dual currencies – in the local currency in which the payments were made and, if different, in the issuer's reporting currency – and further opposed having to electronically tag the dual currency presentations.[418] Those commentators stated that an issuer should only have to present and electronically tag payment information in its reporting currency, which is typically the U.S. dollar.[419] Other commentators opposed a requirement to reconcile payments made in the host country's currency to an issuer's reporting currency or U.S. dollars.[420] Those commentators either supported a requirement to present payments in the currency in which they were made[421] or to permit issuers to choose between presenting payments in either the local currency or its reporting currency as long as

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416 See letter from PetroChina.

417 Letter from PetroChina.

418 See letters from API 1, BP 1, ExxonMobil 1, and RDS 1.

419 See letters from API 1, BP 1, ExxonMobil 1, and RDS 1. One commentator supported requiring only the use of U.S. dollars, regardless of the issuer's reporting currency. See letter from RDS 1.

420 See letters from Cleary, NMA 2, and Rio Tinto; see also letter from PWYP 1.

421 See, e.g., letters from NMA 2 and PWYP 1.

the issuer discloses the methodology for translation and exchange rates used.[422] Commentators noted that the EITI does not require currency conversion and urged the Commission to maintain flexibility in the final rules so that issuers can produce the required information in as efficient a manner as possible, in light of their reporting systems and any local requirements.[423] One commentator asserted that requiring disclosure of the host country currency and the reporting currency could unduly complicate the disclosure.[424]

Commentators also provided views on the proposed requirement to identify the business segment that made the payments. Some commentators suggested defining "business segment":

- according to how an issuer operates its business;[425]
- in a manner that is consistent with the definition used for financial reporting purposes;[426] or
- as a subsidiary if the parent company is making payments on behalf of the subsidiary.[427]

Some commentators opposed requiring an issuer to electronically tag the information to identify the business segment that made the payments on a basis other than as defined under

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422 See letter from Rio Tinto.

423 See letters from Cleary and NMA 2.

424 See letter from NMA 2.

425 See letter from NMA 2.

426 See letters from Cleary and NYSBA Committee.

427 See letter from PWYP 1.

GAAP. According to those commentators, a "definition that differs from GAAP would require companies to gather information in a manner that is not consistent with how the business is structured or how its accounting systems are designed."[428] One commentator stated that the business segment disclosure should be consistent with the Commission's reserve disclosures, which are associated with upstream operations.[429]

Several commentators opposed requiring an issuer to electronically tag each payment according to the project in which it relates because there are some types of payments that are made at the entity level or relate to numerous projects.[430] Those commentators urged us to permit an issuer to identify the government receiving the payments rather than requiring allocation of payments to a particular project in a potentially arbitrary manner.[431] Another commentator stated that an issuer should be allowed to omit the project tag for payments, such as taxes and dividends, which are levied at the entity level, as long as it provides all other required tags.[432]

As noted in Section II.F.1 above, some commentators were of the view that Section 13(q) only requires a compilation of resource extraction issuers' payment information, and not the annual reports containing the issuers' payment disclosures, to be made public, and suggested the compilation could present the payment disclosure only on an aggregated per

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428 Letters from API 1 and ExxonMobil 1.

429 See letter from RDS 1.

430 See letters from API 1, AngloGold, ExxonMobil 1, NMA 2, and RDS 1.

431 See letters from API 1, AngloGold, ExxonMobil 1, NMA 2, and RDS 1.

432 See letter from PWYP 1.

country or similarly high-level basis.[433] Other commentators, however, strongly disagreed with that view and stated that the plain language of Section 13(q) clearly reveals Congress' intent to require the disclosure to investors of disaggregated payment information through the inclusion of that information in an issuer's annual report.[434] Towards that end, one commentator recommended that the compilation take the form of an online database and that a summary report be provided annually.[435]

#### c. Final Rules

We are adopting the requirement regarding the presentation of the mandated payment information substantially as proposed, except that a resource extraction issuer will be required to present the mandated payment information in only one exhibit to new Form SD instead of two exhibits, as proposed. Under the rule as proposed, an issuer would have been required to file one exhibit in HTML or ASCII and another exhibit in the XBRL interactive data format. In proposing the requirement, we noted our belief that requiring two exhibits would provide the information in an easily-readable format in addition to the electronically tagged data that would be readable through a viewer. After further consideration, we have decided to require only one exhibit formatted in XBRL because we believe that we can achieve the goal of the dual presentation with only one exhibit. Issuers will submit the

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433 See letters from API 1, Anadarko, Chamber Energy Institute, Chevron, ExxonMobil 1, Nexen, and RDS 1.

434 See letters from Calvert, PWYP 1, RWI 1, and Sen. Cardin et al. 1.

435 See letter from PWYP 1.

information on EDGAR in XBRL format, thus enabling users of the information to extract the XBRL data, and at the same time the information will be presented in an easily-readable format by rendering the information received by the issuers.[436] We believe that requiring the information to be provided in this way may reduce the compliance burden for issuers.

Similar to the proposal, a resource extraction issuer also must include a brief statement in Item 2.01 of Form SD directing investors to the detailed information about payments provided in the exhibit. By requiring resource extraction issuers to provide the payment information in an exhibit, rather than in the form itself, anyone accessing EDGAR will be able to determine quickly whether an issuer filed a Form SD to satisfy the requirements of Section 13(q) and the related rules.

As noted above, Section 13(q) requires the submission of certain information in interactive data format.[437] Under the final rules, consistent with the proposal and tracking the statutory language, a resource extraction issuer must submit the payment information in XBRL using electronic tags that identify, for any payment required to be disclosed:

- the total amounts of the payments, by category;
- the currency used to make the payments;
- the financial period in which the payments were made;
- the business segment of the resource extraction issuer that made the payments;

436 Users of this information should be able to render the information by using software available free of charge on our website.

437 15 U.S.C. 78m(q)(2)(C) and 15 U.S.C. 78m(q)(2)(D)(ii).

- the government that received the payments, and the country in which the government is located; and
- the project of the resource extraction issuer to which the payments relate.[438]

In addition, a resource extraction issuer must provide the type and total amount of payments made for each project and the type and total amount of payments made to each government in interactive data format. In determining to require the use of XBRL as the interactive data format, we note that a majority of the commentators that addressed the issue supported the use of XBRL.[439] While some commentators suggested allowing a flexible approach to use an interactive data format of their preference,[440] we believe doing so may reduce the comparability of the information and may make it more difficult for interested parties to track payments made to a particular government or project; thus, we are not adopting such an approach.

As mentioned above, several commentators requested that we delay implementation of the tagging requirement until an appropriate XBRL taxonomy for the payment information is available.[441] We note that the staff is currently working to develop the taxonomy for the payment information, and we anticipate that the taxonomy will soon be published for comment. As such, and in light of the implementation period for the payment disclosure,[442]

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438 See Item 2.01(a) of Form SD.

439 See note 410 and accompanying text.

440 See note 413 and accompanying text.

441 See letters from API 1, AngloGold, and ExxonMobil 1.

442 See Section II.G.3. below.

we do not believe it is necessary to provide a delay for the interactive data tagging requirement.

Consistent with the statute, the final rules require a resource extraction issuer to include an electronic tag that identifies the currency used to make the payments. As previously noted, the statute requires a resource extraction issuer to present the type and total amount of payments made for each project and to each government, without specifying how the issuer should report the total amounts. Although some commentators suggested requiring the reporting of payments only in the currency in which they were made,[443] we believe that the statutory requirements to provide a tag identifying the currency used to make the payment and the requirement to provide the total amount of payments by payment type for each project and to each government constrain us to require that issuers perform some currency conversion to the extent necessary.

As noted in an instruction to Form SD, issuers will be required to report the amount of payments made for each payment type, and the total amount of payments made for each project and to each government in either U.S. dollars or the issuer's reporting currency.[444] Thus, in order to provide total amounts, issuers that make payments in other currencies will have to convert those payments into either U.S. dollars or the issuer's reporting currency. We understand issuers' concerns regarding the compliance costs relating to making payments

443 See note 421 and accompanying text.

444 See Instruction 3 to Item 2.01 of Form SD. Currently, foreign private issuers may present their financial statements in a currency other than U.S. dollars for purposes of Securities Act registration and Exchange Act registration and reporting. See Rule 3-20 of Regulation S-X (17 CFR 210.3-20).

in multiple currencies and being required to report the information in another currency.[445] To address these concerns, the final rules permit an issuer to choose between disclosing payments in either U.S. dollars or its reporting currency. In addition, an issuer may choose to calculate the currency conversion between the currency in which the payment was made and U.S. dollars or the issuer's reporting currency, as applicable, in one of three ways: (1) by translating the expenses at the exchange rate existing at the time the payment is made; (2) using a weighted average of the exchange rates during the period; or (3) based on the exchange rate as of the issuer's fiscal year end.[446] A resource extraction issuer must disclose the method used to calculate the currency conversion.[447]

Consistent with Section 13(q) and the proposal, the final rules do not require the resource extraction payment information to be audited or provided on an accrual basis. We note that, in this regard, the EITI approach is fundamentally different from Section 13(q). Under the EITI, companies and the host country's government generally each submit payment information confidentially to an independent administrator selected by the country's multi-stakeholder group, frequently an independent auditor, who reconciles the information provided by the companies and the government, and then the administrator produces a

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445 See, e.g., letters from API 1, BP 1, ExxonMobil 1, NMA 2, and RDS 1. We note that the EITI recommends that oil and natural gas participants report in U.S. dollars, as the quoted market price is in U.S. dollars. It also recommends that mining companies be permitted to use the local currency because most benefit streams for those companies are paid in the local currency. The EITI also suggests that companies may decide to report in both U.S. dollars and the local currency. See the EITI Source Book, at 30.

446 See Instruction 3 to Item 2.01 of Form SD.

447 See id.

report.[448] In contrast, Section 13(q) requires us to issue final rules for disclosure of payments by resource extraction issuers; it does not contemplate that an administrator will audit and reconcile the information, or produce a report as a result of the audit and reconciliation. In addition, we recognize the concerns raised by some commentators that an auditing requirement for the payment information would significantly increase implementation and ongoing reporting costs. We believe that not requiring the payment information to be audited or provided on an accrual basis is consistent with Section 13(q) because the statute refers to "payments" and does not require the information to be included in the financial statements.[449] In addition, not requiring the information to be audited or provided on an accrual basis may result in lower compliance costs than otherwise would be the case if resource extraction issuers were required to provide audited information.

Consistent with the statute, the final rules require a resource extraction issuer to include an electronic tag that identifies the business segment of the resource extraction issuer that made the payments. As suggested by commentators,[450] we are defining "business segment" to mean a business segment consistent with the reportable segments used by the resource extraction issuer for purposes of financial reporting.[451] We believe that defining

448 See EITI Source Book, at 23 ("It will be necessary to appoint an administrator to collect and evaluate the revenue data provided by companies and government. It is essential that there is stakeholder trust in the administrator's impartiality and competency. The administrator may be a private audit firm, an individual or an existing or specially created official body that is universally regarded as independent of, and immune to influence by, the government.").

449 See note 405 and accompanying text.

450 See note 426 and accompanying text.

451 See Item 2.01(c)(4) of Form SD. The term "reportable segment" is defined in FASB ASC Topic 280, Segment Reporting, and IFRS 8, Operating Segments.

"business segment" in this way will enable issuers to report the information according to how they currently report their business operations, which should help to reduce compliance costs.

We note that some of the electronic tags, such as those pertaining to category, currency, country, and financial period will have fixed definitions and will enable interested persons to evaluate and compare the payment information across companies and governments. Other tags, such as those pertaining to business segment, government, and project, will be customizable to allow issuers to enter information specific to their business. To the extent that payments, such as corporate income taxes and dividends, are made for obligations levied at the entity level, issuers may omit certain tags that may be inapplicable (e.g., project tag, business segment tag) for those payment types as long as they provide all other electronic tags, including the tag identifying the recipient government.[452]

As discussed in greater detail above, we agree with those commentators who stated that the public compilation was not intended to be a substitute for the payment disclosure required of resource extraction issuers under Section 13(q),[453] and we have not yet determined the content, form, or frequency of any such compilation.[454] We note that users of

452 See note 432 and accompanying text.

453 See note 434 and accompanying text.

454 In this regard, we note that members of Congress, including one of the sponsors of the provision, submitted a comment letter stating "Section 1504 requires companies to report the information in an interactive format so that the information is readily usable by investors and the public -the basic intent of the section. Section 1504 also suggests that if practicable, the SEC can make a compilation of all the data available to investors and the public for ease of use. This compilation would be in addition to the public availability of the original company data and in no way is expected to replace the public availability of that data." See letter from Sen. Cardin et al. 1.

the information will be able to compile the information in a manner that is most useful to them by using the electronically-tagged data filed by resource extraction issuers.

### 3. Treatment for Purposes of Securities Act and Exchange Act

#### a. Proposed Rules

As noted in the proposal, the statutory language of Section 13(q) does not specify that the information about resource extraction payments must be "filed," rather, it states that the information should be "include[d] in an annual report[.]"[455] As proposed, the rules would have required the disclosure of payment information to be "furnished" rather than "filed" and not subject to liability under Section 18 of the Exchange Act, unless the issuer explicitly states that the resource extraction disclosure is filed under the Exchange Act.

#### b. Comments on the Proposed Rules

Numerous commentators stated their belief that the payment disclosure should be furnished rather than filed and, therefore, not subject to Exchange Act Section 18 liability.[456] Such commentators expressed the view that the nature and purpose of the Section 13(q) disclosure requirements is not primarily for the protection of investors but, rather, to increase the accountability of governments for the proceeds they receive from their natural resources and, thus, to support the commitment of the Federal Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or

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[455] 15 U.S.C. 78m(q)(2)(A).

[456] See letters from API 1, AngloGold, Barrick Gold, BP 1, Cleary, ExxonMobil 1, NMA 2, NYSBA Committee, PetroChina, PWC, and RDS 1.

minerals.[457] One commentator stated that "requiring [the disclosure to be filed] could indirectly increase the costs of Securities Act disclosures that incorporate the filing by reference (raising underwriting, auditing, and perhaps even credit rating costs)."[458] Two commentators requested that if the final rules require an issuer to include the disclosure in an existing Exchange Act annual report, the rules should not extend the officer certifications required by Exchange Act Rules 13a-14, 13a-15, 15d-14, and 15d-15 to that disclosure.[459]

Numerous other commentators disagreed with the proposal and urged the Commission to require the payment disclosures to be filed rather than furnished and subject to Section 18 liability.[460] Several commentators believed that the plain language of the statute requires filing of the disclosure.[461] Commentators also asserted that one of the goals of Section 13(q) is to enhance investor protection from risks inherent in the extractive industries, and therefore the nature and purpose of Section 13(q) is not qualitatively different than other disclosure that has historically been required under Section 13.[462] According to those commentators, the best way to enhance investor protection would be to require that

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457 See, e.g., letters from API 1 and AngloGold.

458 See letter from NMA 2.

459 See letters from Cleary and NYSBA Committee.

460 See letters from Bon Secours, Calvert, CRS, Earthworks, EIWG, ERI, ERI 2, Global Financial 2, Global Witness 1, Greenpeace, HII, HURFOM 1, HURFOM 2, Newground, ONE, Oxfam 1, PGGM, PWYP 1, RWI 1, Sanborn, Sen. Cardin et al. 1, Sen. Cardin et al. 2, Sen. Levin 1, Soros 1, TIAA, USAID, USW, and WRI.

461 See letters from Calvert, Global Witness 1, PWYP 1, and Sen. Cardin et al. 1.

462 See, e.g., letters from Global Witness 1, PWYP 1, Sen. Cardin et al. 1, and Sen. Levin 1; see also letter from Sen. Cardin et al. 2.

resource extraction payment disclosures be filed rather than furnished; otherwise, investor confidence in the accuracy of the disclosures would be undermined.[463] Some commentators stated that requiring the disclosure to be furnished rather than filed would deprive investors of causes of action in the event that the disclosure is false or misleading.[464]

In addition, several commentators opposed extending the disclosure requirements to registration statements under the Securities Act.[465] In opposing such an extension of the requirements, one commentator stated that "the purpose of these disclosures is not to inform investors...so there is no logical reason for such inclusion. Also, inclusion would raise nettlesome concerns relating to liability, and directors' and underwriters' due diligence obligations, for no good reason."[466] Other commentators, however, believed that the Commission should require the inclusion of the payment information in Securities Act registration statements.[467]

### c. Final Rules

Although the proposed rules would have required the payment information to be furnished, after considering the comments, the final rules we are adopting require resource extraction issuers to file the payment information on new Form SD. As discussed above,

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463 See, e.g., letters from Global Witness 1, PWYP 1, and Sen. Levin 1.

464 See letters from Global Witness 1, Oxfam 1, PWYP 1, Sen. Cardin et al. 1, and Sen. Levin 1; see also letter from Sen. Cardin et al. 2.

465 See letters from API 1, AngloGold, Cleary, ExxonMobil 1, NMA 2, NYBSA Committee, RDS 1 and Statoil.

466 Letter from NYSBA Committee.

467 See letters from Calvert, Earthworks, and PWYP 1.

commentators disagreed as to whether the required information should be furnished or filed,[468] and Section 13(q) does not state how the information should be submitted. In reaching our conclusion that the information should be "filed" instead of "furnished" we note that the statute defines "resource extraction issuer" in part to mean an issuer that is required to file an annual report with the Commission,[469] which, as commentators have noted, suggests that the annual report that includes the required payment information should be filed.[470] Additionally, many commentators believed that investors would benefit from the payment information being "filed" and subject to Exchange Act Section 18 liability.[471] Some commentators asserted that allowing the information to be furnished would diminish the importance of the information.[472] Some commentators believed that requiring the information to be filed would enhance the quality of the disclosure.[473] In addition, some commentators argued that the information required by Section 13(q) differs from the information that the Commission permits issuers to furnish and that the information is

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468 Compare letters from API 1, AngloGold, Barrick Gold, BP 1, Cleary, ExxonMobil 1, NMA 2, NYSBA Committee, PetroChina, PWC, and RDS 1 (supporting a requirement to furnish the disclosure) with letters from Bon Secours, Calvert, Earthworks, EIWG, ERI, ERI 2, Global Financial 2, Global Witness 1, HII, HURFOM 1, HURFOM 2, Newground, ONE, Oxfam 1, PGGM, PWYP 1, RWI 1, Sanborn, Sen. Cardin et al. 1, Sen. Cardin et al. 2, Sen. Levin 1, Soros 1, TIAA, USAID, USW, and WRI (supporting a requirement to file the disclosure).

469 15 U.S.C. 78m(q)(1)(D)(i).

470 See letters from Global Witness 1, PWYP 1, and Sen. Cardin et al.

472 See letters from Calvert and Global Witness 1.

473 See letters from HURFOM, Global Witness 1, and PWYP 1.

qualitatively similar to disclosures that are required to be filed under Exchange Act Section 13.[474]

Other commentators supporting the proposal that the disclosure be furnished argued that the information is not material to investors.[475] We note, however, other commentators, including investors, argued that the information is material.[476] Given the disagreement, and that materiality is a fact specific inquiry, we are not persuaded that this is a reason to provide that the information should be furnished. Additionally, while we appreciate the comments that the payment information should be furnished and not subject to Section 18 liability, we note that Section 18 does not create strict liability for filed information. Rather, it states that a person shall not be liable for misleading statements in a filed document if it can establish that it acted in good faith and had no knowledge that the statement was false or misleading.[477] As noted above, because the disclosure is in a new form, rather than in

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474 See letters from ERI 1, HII, Oxfam 1, PGGM, PWYP 1, Sen. Cardin et al. 1, and Soros 1.

475 See letters from API 1, ExxonMobil 1, and RDS 1; see also letter from AngloGold.

476 See letters from Calvert, ERI 1, Soros 1, Global Financial Integrity (January 28, 2011) ("Global Financial Integrity 1"), Global Witness 1, HII, Oxfam, Sanborn, PGGM, PWYP 1, Sen. Cardin et al. 1, and TIAA.

477 Exchange Act Section 18(a) provides: "Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant." A plaintiff asserting a claim under Section 18 would need to meet the elements of the statute to establish a claim, including reliance and damages.

issuers' Exchange Act annual reports, the filed disclosure is not subject to the officer certifications required by Rules 13a-14 and 15d-14 under the Exchange Act.

We also note a commentator stated that filing the disclosure would require auditors to consider whether the resource extraction payment disclosures are materially inconsistent with the financial statements thereby increasing the cost.[478] We note however, that unlike the proposal, the disclosure will not be required in the Form 10-K but instead will be required in new Form SD, which does not include audited financial statements, and therefore will not be subject to this potential increased cost.

**G. Effective Date**

**1. Proposed Rules**

In the Proposing Release, we requested comment on whether we should provide a delayed effective date for the final rules and whether doing so would be consistent with the statute.

**2. Comments on the Proposed Rules**

Some commentators believed that the final rules should be effective for fiscal years ending on or after April 15, 2012, without exception.[479] One of those commentators believed

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In addition, we note that issuers that fail to comply with the final rules could also be violating Exchange Act Sections 13(a) and (q) and 15(d), as applicable. Issuers also would be subject to potential liability under Exchange Act Section 10(b) [15 U.S.C. 78j] and Rule 10b-5 [17 CFR 240.10b-5], promulgated thereunder, for any false or misleading material statements in the information disclosed pursuant to the rule.

478 See letter from PWC.

479 See letters from Earthworks and PWYP 1. A third commentator urged the Commission to follow the statutory effective date because of the current consideration by the EC of extractive industry disclosure rules in the EU, which could follow the U.S. standard. See letter from PWYP U.K.

that providing exceptions would go against the principle of equal treatment of issuers.[480] Another commentator stated that implementation of the final rules should not be delayed because "companies have known of the possibility of disclosure regulations for many years."[481]

Other commentators suggested delaying the effective date of the final rules because compliance with the final rules would necessitate significant changes to resource planning systems.[482] Commentators maintained that we have the flexibility to delay the effective date because Section 13(q) states that the disclosure must be provided not earlier than for the fiscal year ending one year after issuance of the final rules.[483] Some commentators stated that an effective date for 2012 is feasible only if the scope of the required disclosure is limited.[484] These commentators suggested further delaying the effective date if the final rules include, among other things, an audit requirement, downstream activities, a granular definition of project (e.g., a definition that precludes disclosure at the country or entity level), preparation of disclosures on a cash basis, or required reporting in multiple currencies.[485] Some commentators urged the delay of the effective date due to the need to implement new

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480 See letter from PWYP 1.

481 See letter from Earthworks.

482 See letters from API 1, ExxonMobil 1, Chevron, and RDS 1.

483 See letters from Cleary and NMA 2.

484 See letters from API 1, Chevron, ExxonMobil 1, and NMA 2.

485 See letters from API 1, Chevron, ExxonMobil 1, and NMA 2.

accounting standards.[486] Commentators suggested that we require compliance with the rule for 2013, 2014, or 2015.[487]

Some commentators believed that all resource extraction issuers should be subject to the same effective date.[488] One commentator suggested a phase-in approach requiring large accelerated filers to provide the disclosure for fiscal years ending on or after July 1, 2012 and for all others to provide the disclosure for fiscal years ending on or after July 1, 2013.[489] The commentator believed that a phase-in approach would reduce costs for smaller issuers because it would enable those issuers to observe how larger issuers comply with the new rules.[490] Another commentator stated that a phase-in would be appropriate for smaller reporting companies.[491]

### 3. Final Rules

Under the final rules, a resource extraction issuer will be required to comply with new Rule 13q-1 and Form SD for fiscal years ending after September 30, 2013. The final rules will require a resource extraction issuer to file with the Commission for the first time an annual report that discloses the payments it made to governments for the purpose of the commercial development of oil, natural gas, or minerals. Based on the comments we

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486 See letters from Nexen, PetroChina, PWC, and RDS 1.

487 See letters from Barrick Gold (fiscal year 2013), PetroChina (fiscal years ending on or after December 31, 2015); PwC (annual periods beginning after December 31, 2012).

488 See letters from API 1, Chevron, ExxonMobil 1, and RDS 1.

489 See letter from AngloGold.

490 See id.

491 See letter from Cleary.

received, we understand that resource extraction issuers will need time to undertake significant changes to their reporting systems and processes to gather and report the payment information. Even for those issuers that provide some payment disclosure voluntarily or as part of an EITI program, compliance with the final rules will likely require changes in their reporting systems.[492] In light of this, we believe it is appropriate to provide all issuers with a reasonable amount of time to make such changes and to allow a transition period for reporting. Therefore, the final rules provide that for the first report filed for fiscal years ending after September 30, 2013, a resource extraction issuer may provide a partial year report if the issuer's fiscal year began before September 30, 2013. The issuer will be required to provide a report for the period beginning October 1, 2013 through the end of its fiscal year. For example, a resource extraction issuer with a December 31, 2013 fiscal year end will be required to file a report disclosing payments made from October 1, 2013 – December 31, 2013. For any fiscal year beginning on or after September 30, 2013, a resource extraction issuer will be required to file a report disclosing payments for the full fiscal year.

We believe that requiring compliance with the final rules for fiscal years ending after September 30, 2013 and providing a transition period in which partial year reports are permitted will provide time for issuers to effect the changes in their reporting systems .

492 For example, issuers reporting under EITI programs that require material information to be reported at the country level will likely need to further develop their systems to gather and report information at the project level and meeting the "not de minimis" threshold.

necessary to gather and report the payment information required by the final rules.[493] We recognize that adoption of this compliance date and transition period means that most companies will provide partial year reports for the first report required under the rules. We believe this result is required, however, to enable issuers to make the changes to their reporting systems necessary to achieve full compliance with the final rules.

If any provision of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application. Moreover, if any portion of Form SD not related to resource extraction disclosure is held invalid, such invalidity shall not affect the use of the form for purposes of disclosure pursuant to Section 13(q).

## III. ECONOMIC ANALYSIS

### A. Introduction

As discussed in detail above, we are adopting the new rules and amendment to Form SD discussed in this release to implement Section 13(q), which was added to the Exchange Act by Section 1504 of the Act. The new rules and revised form will require a resource extraction issuer to disclose in an annual report filed with the Commission on Form SD certain information relating to payments made by the issuer, a subsidiary of the issuer, or an entity under the control of the issuer to a foreign government or the U.S. Federal

493 In this regard, we note changes required to internal tracking and reporting systems will likely be specific to the particular company and therefore we believe it is unlikely that smaller issuers would benefit from a phase-in that would allow them to observe how larger issuers comply with the new rules.

Government for the purpose of the commercial development of oil, natural gas, or minerals. The information will include the type and total amount of payments made for each project of the issuer relating to the commercial development of oil, natural gas, or minerals as well as the type and total amount of payments made to each government. We expect that the final rules will affect in substantially the same way both U.S. companies and foreign companies that meet the definition of "resource extraction issuer," which is an issuer that is required to file an annual report with the Commission and engages in the commercial development of oil, natural gas, or minerals.

Since Congress adopted Section 13(q) in July 2010, we have sought comment on our implementation of the provision and provided opportunities for commentators to provide input. Members of the public interested in making their views known were invited to submit comment letters in advance of when the official comment period for the proposed rules opened, and the public had the opportunity to submit comment on the proposal during the comment period. In addition, in response to the suggestion by some commentators that we extend the comment period to allow the public additional time to thoroughly consider the matters addressed in the Proposing Release and to submit comprehensive responses, we extended the comment period for an additional 30 days[494] and have continued to receive comment letters after the extended deadline, all of which we have considered. We believe interested parties have had ample opportunity to review the proposed rules, as well as the

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[494] See Exchange Act Release No. 34-67395 (January 28, 2011), 76 FR 6111 (February 3, 2011), available at http://www.sec.gov/rules/proposed/2011/34-63795.pdf. This robust, public input has allowed us to more fully consider how to develop the final rules.

comment letters, and to provide views on the proposal, other comment letters, and data to inform our consideration of the final rules. Accordingly, we do not believe that a re-proposal is necessary.

The Proposing Release cited some pre-proposal letters we received from commentators indicating the potential impact of the proposed rules on competition and capital formation. In addition to requesting comment throughout the Proposing Release on the proposals and on potential alternatives to the proposals, the Commission also solicited comment in the Proposing Release on whether the proposals, if adopted, would promote efficiency, competition, or capital formation, or have an impact or burden on competition. We also requested comment on the potential effect on efficiency, competition, or capital formation should the Commission not adopt certain exceptions or accommodations. As discussed throughout this release, we received many comments addressing the potential economic and competitive impact of the proposed rules. Indeed, many commentators provided multiple comment letters to support, expand upon, or contest views expressed by other commentators.[495]

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[495] See, e.g., letters from API 1, API 2, API 3, American Petroleum Institute (February 13, 2012), ExxonMobil 1, ExxonMobil 2, ExxonMobil 3, Global Witness 1, Global Witness 2, Global Witness 3, PWYP 1, PWYP 2, PWYP 3, PWYP 4, PWYP 5, ERI 1, ERI 2, ERI 3, ERI 4, Oxfam 1, Oxfam 2, RELUFA 1, RELUFA 2, RELUFA 3, RWI 1, RWI 2, RDS 1, RDS 2, RDS 3, RDS 4, Sen. Cardin et al. 1, Sen. Cardin et al. 2, Sen. Levin 1, Sen. Levin 2, Soros 1, and Soros 2. One commentator urged us to re-propose the rules in order to give the public an additional opportunity to comment on and inform the Commission's assessment of the economic impact of the proposed rules. See letter from API 3. As described above, we believe interested parties have had ample opportunity to review the proposed rules, as well as the comment letters, and to provide views and data to inform our consideration of the economic effects of the final rules.

Section 13(q) of the Exchange Act requires us to issue rules to implement the disclosure requirement for certain payments made by resource extraction issuers to the Federal Government and foreign governments. Congress intended that the rules issued pursuant to Section 13(q) would increase the accountability of governments to their citizens in resource-rich countries for the wealth generated by those resources.[496] This type of social benefit differs from the investor protection benefits that our rules typically strive to achieve. We understand that the statute is seeking to achieve this benefit by mandating a new disclosure requirement under the Exchange Act that requires resource extraction issuers to identify and report payments they make to governments and that supports international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals.[497] In addition, some commentators stated that the information disclosed pursuant to Section 13(q) would benefit investors, by among other things, helping investors model project cash flows and assess political risk, acquisition costs, and management effectiveness.[498] Moreover, investors and other market participants, as well as civil society in countries that are resource-rich, may benefit from any increased economic and political stability and improved investment climate that transparency promotes. Commentators and

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496 See note 7 and accompanying text.

497 See note 8 and accompanying text.

498 See, e.g., letters from Calvert, CALPERS, and Soros 1.

the sponsors of Section 13(q) also have noted that the United States has an interest in promoting accountability, stability, and good governance.[499]

We are sensitive to the costs and benefits of the final rules, and Exchange Act Section 23(a)(2) requires us, when adopting rules, to consider the impact that any new rule would have on competition. In addition, Section 3(f) of the Exchange Act requires us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. We have considered the costs and benefits imposed by the rule and form amendments we are adopting, as well as their effects on efficiency, competition, and capital formation. Many of the economic effects of the rules stem from the statutory mandate, while others are affected by the discretion we exercise in implementing the Congressional mandates. The discussion below addresses the costs and benefits resulting from both the statute and our exercise of discretion, and the comments we received about these matters. In addition, as discussed elsewhere in this release, we recognize that the rules will impose a burden on competition,

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499 See, e.g., letter from Sen. Cardin (February 28, 2012) (includes a transcript of testimony from Secretary of State Hilary Rodham Clinton before the Senate Foreign Relations Committee). See also statement from Senator Cardin regarding the provision ("...Transparency helps create more stable governments, which in turn allows U.S. companies to operate more freely -- and on a level playing field -- in markets that are otherwise too risky or unstable."), 156 CONG. REC. S5870 (daily ed. Jul. 15, 2010) (statement of Sen. Cardin); and Senator Lugar regarding the provision ("...Transparency empowers citizens, investors, regulators, and other watchdogs and is a necessary ingredient of good governance for countries and companies alike.. . Transparency also will benefit Americans at home. Improved governance of extractive industries will improve investment climates for our companies abroad, it will increase the reliability of commodity supplies upon which businesses and people in the United States rely, and it will promote greater energy security." 156 CONG. REC. S3816 (daily ed. May 17, 2010) (statement of Sen. Lugar)).

but we believe that any such burden that may result is necessary in furtherance of the purposes of Exchange Act Section 13(q).

After analyzing the comments and taking into account additional data and information, we believe it is likely that the total initial cost of compliance for all issuers is approximately $1 billion and the ongoing cost of compliance is between $200 million and $400 million. We reach these estimates by considering carefully all comments we received on potential costs. We relied particularly on those comment letters that provided quantification and were transparent about their methodologies. As discussed in more detail below, after thoroughly considering each comment letter, we determined that it was appropriate to modify and/or expand upon some of the submitted estimates and methodologies to reflect data and information submitted by other commentators, as well as our own judgment, experience, and expertise. Our considered estimate of the total costs thus reflects these synthesized data and analyses. We consider the full range of these costs in the following sections, although where it is possible to discuss separately the costs and benefits related to our discretionary choices in the rules, we attempt to do so.[500]

Given the specific language of the statute and our understanding of Congress' objectives, we believe it is appropriate for the final rules generally to track the statutory provision. Our discretionary authority to implement Section 13(q) is limited, and we are committed to executing the Congressional mandate. Throughout this release, and in the

500 As discussed above, our discretionary choices are informed by the statutory mandate and thus, discussion of the benefits and costs of those choices will necessarily involve the benefits and costs of the underlying statute.

following economic analysis, we discuss the benefits and costs arising from both the new reporting requirement mandated by Congress and from those choices in which we have exercised our discretion. Sections III.B. and III.C. below provide a narrative discussion of the costs and benefits of resulting from the mandatory reporting requirement and our exercise of discretion, respectively. In Section III.D. below, based on commentators' estimates and our estimates, we provide a quantitative discussion of the costs associated with the final rules as adopted.[501]

### B. Benefits and Costs Resulting from the Mandatory Reporting Requirement

#### 1. Benefits

As noted above, Congress intended that the rules issued pursuant to Section 13(q) would increase the accountability of governments to their citizens in resource-rich countries for the wealth generated by those resources.[502] In addition, commentators and the sponsors of Section 13(q) also have noted that the United States has an interest in promoting accountability, stability, and good governance.[503] Congress' goal of enhanced government accountability through Section 13(q) may result in social benefits that cannot be readily quantified with any precision.[504] We also note that while the objectives of Section 13(q) do

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[501] As noted below, Congress' goal of enhanced accountability through Section 13(q) is an intended social benefit that cannot be readily quantified with any precision, and therefore, our quantitative analysis focuses on the costs.

[502] See note 7 and accompanying text.

[503] See note 499 and accompanying text.

[504] These benefits could ultimately be quite significant given the per capita income of the potentially affected countries.

not appear to be ones that will necessarily generate measurable, direct economic benefits to investors or issuers, investors have stated that the disclosures required by Section 13(q) have value to investors and can "materially and substantially improve investment decision making."[505]

Many commentators stated that they support the concept of increasing transparency of resource extraction payments.[506] While commentators stated that a benefit of increasing transparency is increased government accountability, some commentators also noted that the new disclosure requirements would help investors assess the risks faced by resource extraction issuers operating in resource-rich countries.[507] To the extent that investors want information about payments to assess these risks, the rules may result in increased investment by those investors and thus may increase capital formation.

Several commentators noted that the statutory requirement to provide project-level disclosure significantly enhances the benefits of the mandatory reporting required under Section 13(q).[508] One commentator stated that the benefits to civil society of project-level reporting are significantly greater than those of country-level reporting.[509] This commentator stated that project-level data will enable civil society groups, representing local communities,

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505 Calvert (March 1, 2011). See note 498 and accompanying text.

506 See, e.g., letters from API 1, Calvert, Chamber Energy Institute, ExxonMobil 1, Global Witness 1, Oxfam 1, Petrobras, PWYP 1, RDS 1, and Statoil.

507 See, e.g., letters from Calvert, ERI 2, Global Witness 1, and Oxfam 1.

508 See, e.g., letters from Global Witness 1, Oxfam 1, PWYP 1, RWI 1, and Syena.

509 See letter from ERI 1; see also letter from Gates Foundation.

to know how much their governments earn from the resources that are removed from their respective territories and empower them to advocate for a fairer share of revenues, double-check government-published budget data, and better calibrate their expectations from the extractive companies.[510] This commentator further stated that project-level reporting will enable both local government officials and civil society groups to monitor the revenue that flows back to the regions from the central government and ensure that they receive what is promised – a benefit that would be unavailable if revenue streams were not differentiated below the country level.[511] Another commentator noted that project-level reporting would shine greater light on dealings between resource extraction issuers and governments, thereby providing companies with "political cover to sidestep government requests to engage in potentially unethical activities."[512]

One commentator noted the benefits to investors of project-level reporting.[513] One benefit cited by this commentator is that project-level reporting will enable investors to better understand the risk profiles of individual projects within a given country, which may vary greatly depending on a number of factors such as regional unrest, personal interest by powerful government figures, degree of community oppression, and environmental

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510 See letter from ERI 1; see also letter from Gates Foundation (stating that it is important to seek disclosure below the country level, that project-level disclosure will give both citizens and investors valuable information, and that defining "project" as a geologic basin or province would be of limited use to both citizens and investors).

511 See letter from ERI 1.

512 See letter from EG Justice.

513 See letter from ERI 2.

sensitivity.[514] This commentator indicated that project-level disclosures will enable investors to better understand these risks, whereas country-level reporting would allow companies to mask particularly salient projects by aggregating payments with those from less risky projects.[515] The commentator noted that unusually high signing bonus payments for a particular project may be a proxy for political influence, whereas unusually low tax or royalty payments may signal that a project is located in a zone vulnerable to attacks or community unrest.[516] A further benefit of project-level disclosures is that it would assist investors in calculations of cost curves that determine whether and for how long a project may remain economical, using a model that takes into account political, social, and regulatory risks.[517]

There also may be a benefit to investors given the view expressed by some commentators that new disclosure requirements would help investors assess the risks faced by resource extraction issuers operating in resource-rich countries. To the extent that the required disclosure will help investors in pricing the securities of the issuers subject to the requirement mandated by Section 13(q), the rules could improve informational efficiency. One commentator indicated that project-level disclosures will promote capital formation by reducing information asymmetry and providing more security and certainty to investors as to

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514 See id.

515 See id.

516 See id.

517 See letter from Calvert Asset Management Company and SIF (November 15, 2010) (pre-proposal letter).

extractive companies' levels of risk exposure.[518] One commentator was of the view that improved transparency regarding company payments of royalties, taxes, and production entitlements on a country level would provide institutional investors, such as the commentator, with the necessary information to assess a company's relative exposure to country-specific risks including political and regulatory risks, and would contribute to good governance by host governments.[519] Similarly, another commentator was of the view that in countries where governance is weak, the resulting corruption, bribery, and conflict could negatively affect the sustainability of a company's operations, so Section 13(q) would benefit companies' operations and investors' ability to more effectively make investment decisions.[520] One commentator anticipated benefits of lower capital costs and risk premiums as a result of improved stability stemming from the statutory requirements and lessened degree of uncertainty promoted by greater transparency.[521] This same commentator believed that the disclosure standardization imposed through Section 13(q) would be of particular benefit to long-term investors by providing a model for data disclosure as well as help to address some of the key challenges faced by EITI implementation.[522] Another commentator

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518 See letter from ERI 2.

519 See letter from PGGM. This commentator also noted that the disclosure required by Section 13(q) would provide in-country activists with information to hold their governments accountable.

520 See letter from CalPERS.

521 See letter from Hermes.

522 See letter from Hermes.

maintained that transparency of payments is a better indicator of risk for extractive companies than the bond markets and is also a better indicator of financial performance.[523]

### 2. Costs

Many commentators stated that the reporting regime mandated by Section 13(q) would impose significant compliance costs on issuers. Several commentators addressed Paperwork Reduction Act ("PRA")-related costs specifically,[524] while others discussed the costs and burdens to issuers generally as well as costs that could have an effect on the PRA analysis.[525] As discussed further in Section III.D. below, in response to comments we received, we have provided our estimate of both initial and ongoing compliance costs. In addition, also in response to comments, we have made several changes to our PRA estimates that are designed to better reflect the burdens associated with the new collections of information.

Some commentators disagreed with our industry-wide estimate of the total annual increase in the collection of information burden and argued that it underestimated the actual costs that would be associated with the rules.[526] Some commentators stated that, depending upon the final rules adopted, the compliance burdens and costs caused by implementation and ongoing compliance with the rules would be significantly greater than those estimated by

523 See letter from Vale Columbia Center (December 16, 2011).

524 See letters from API 1, API 2, Barrick Gold, ERI 2, ExxonMobil 1, ExxonMobil (October 25, 2011) ("ExxonMobil 3"), NMA 2, Rio Tinto, RDS 1, and RDS 4.

525 See, e.g., letters from BP 1, Chamber Energy Institute, Chevron, Cleary, Hermes, and PWYP 1.

526 See letters from API 1 and ExxonMobil 1.

the Commission.[527] Significantly, however, in general these commentators did not provide any quantitative analysis to support their estimates.[528]

Some commentators noted that modifications to issuers' core enterprise resource planning systems and financial reporting systems will be necessary to capture and report payment data at the project level, for each type of payment, government payee, and currency of payment.[529] Commentators provided examples of such modifications including establishing additional granularity to existing coding structures (e.g., splitting accounts that contain both government and non-government payment amounts), developing a mechanism to appropriately capture data by "project," building new collection tools within financial reporting systems, establishing a trading partner structure to identify and provide granularity around government entities, establishing transaction types to accommodate types of payment (e.g., royalties, taxes, bonuses, etc.), and developing a systematic approach to handle "in-kind" payments.[530] These commentators estimated that the resulting initial implementation costs would be in the tens of millions of dollars for large issuers and millions of dollars for

527 See letters from API 1, API 2, API 3, Barrick Gold, ExxonMobil 1, NMA 2, Rio Tinto, and RDS 1.

528 See letters from API 1 and ExxonMobil 1. ExxonMobil 1 does provide estimated implementation costs of $50 million if the definition of "project" is narrow and the level of disaggregation is high across other reporting parameters. This estimate is used in our analysis of the expected implementation costs.

529 See letters from API 1 and ExxonMobil 1. See also letter from RDS 1.

530 See letters from API 1 and ExxonMobil 1.

many small issuers.[531] Two commentators also estimated that total industry costs for initial implementation of the final rules could amount to hundreds of millions of dollars.[532]

These commentators also noted, however, that these costs could be increased significantly depending on the scope of the final rules.[533] For example, commentators suggested that these cost estimates could be greater depending on the how the final rules define "project," and whether the final rules require reporting of non-consolidated entities, require "net" and accrual reporting, or include an audit requirement.[534] Another commentator estimated that the initial set up time and costs associated with the rules implementing Section 13(q) would require 500 hours to effect changes to its internal books and records, and $100,000 in IT consulting, training, and travel costs.[535] One commentator representing the mining industry estimated that start-up costs, including the burden of establishing new reporting and accounting systems, training local personnel on tracking and reporting, and developing guidance to ensure consistency across reporting units, would be at least 500 hours for a mid-to-large sized multinational company.[536]

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531 See letters from API 1, ExxonMobil 1, and RDS 1. These commentators did not describe how they defined small and large issuers.

532 See letters from API 1 and ExxonMobil 1.

533 See letters from API 1, ExxonMobil 1, and RDS 1.

534 See letters from API 1, ExxonMobil 1, and RDS 1. As previously discussed, the final rules do not require the payment information to be audited or reported on an accrual basis, so commentators' concerns about possible costs associated with these items should be alleviated. See Section II.F.2.c. above.

535 See letter from Barrick Gold.

536 See letter from NMA 2.

Two commentators stated that arriving at a reliable estimate for the ongoing annual costs of complying with the rules would be difficult because the rules were not yet fully defined, but suggested that a "more realistic" estimate than the estimate included in the Proposing Release is hundreds of hours per year for each large issuer with many foreign locations.[537] Commentators also indicated that costs related to external professional services would be significantly higher than the Commission's estimate, resulting primarily from XBRL tagging and higher printing costs, although these commentators noted that it is not possible to estimate these costs until the final rules are fully defined.[538]

One commentator estimated that ongoing compliance with the rules implementing Section 13(q) would require 100-200 hours of work at the head office, an additional 100-200 hours of work providing support to its business units, and 40-80 hours of work each year by each of its 120 business units, resulting in a total of approximately 4,800-9,600 hours and costs approximating between $2,000,000 to $4,000,000.[539] One commentator, a large multinational issuer, estimated an additional 500 hours each year, including time spent to review each payment to determine if it is covered by the reporting requirements and ensure it is coded to the appropriate ledger accounts.[540] Another commentator representing the mining

537 See letters from API 1 and ExxonMobil 1 (each noting that estimates would increase if the final rules contain an audit requirement, or if the final rules are such that issuers are not able to automate material parts of the collection and reporting process).

538 See letters from API 1 and ExxonMobil 1.

539 See letter from Rio Tinto. These estimates exclude initial set-up time required to design and implement the reporting process and develop policies to ensure consistency among business units. They also assume that an audit is not required.

540 See letter from Barrick Gold.

industry estimated that the annual burden for a company with a hundred projects or reporting units, the burden could "easily reach nearly" 10 times the estimate set out in the Proposing Release.[541] This commentator noted that its estimate takes into account the task of collecting, cross-checking, and analyzing extensive and detailed data from multiple jurisdictions around the world, as well as the potential for protracted time investments (a) seeking information from certain non-consolidated entities that would be considered "controlled" by the issuer, (b) attempting to secure exceptions from foreign confidentiality restrictions, (c) obtaining compliance advice on the application of undefined terms such as "not de minimis" and "project" and implementing new systems based upon those definitions, (d) responding to auditor comments or queries concerning the disclosure, which, although not in the financial statements would, under the proposed rules, be a furnished exhibit to Form 10-K or equivalent report for foreign issuers, and (e) any necessary review of Section 13(q) disclosures in connection with periodic certifications under the Sarbanes-Oxley Act.[542] This commentator also noted that the estimate in the Proposing Release did not adequately capture the burden to an international company with multiple operations where a wide range of personnel will need to be involved in capturing and reviewing the data for the required disclosures as well as for electronically tagging the information in XBRL format.[543] A

541 See letter from NMA 2. The estimate provided in the Proposing Release was for the PRA analysis.

542 See letter from NMA 2.

543 See letter from NMA 2.

number of commentators submitted subsequent letters reiterating and emphasizing the potential of the proposed rules to impose substantial costs.[544]

Other commentators believed that concerns over compliance costs have been overstated.[545] One commentator stated that most issuers already have internal systems in place for recording payments that would be required to be disclosed under Section 13(q) and that many issuers currently are subject to reporting requirements at a project level.[546] Another commentator anticipated that while the rules will likely result in additional costs to resource extraction issuers, such costs would be marginal in scale because in the commentator's experience many issuers already have extensive systems in place to handle their current reporting requirements, and any adjustments needed as a result of Section 13(q) could be done in a timely and cost-effective manner.[547] Another commentator believed that issuers could adapt their current systems in a cost-effective manner because issuers should be able to adapt a practice undertaken in one operating environment to those in other countries without substantial changes to the existing systems and processes of an efficiently-run enterprise.[548]

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544 See letters from API 2, ExxonMobil 3, and RDS 4.

545 See letters from ERI 2, Oxfam 1, PWYP 1, and RWI 1.

546 See letter from RWI 1. This commentator stated that issuers already have internal systems in place for reporting requirements at the project level "as [RWI] believe[s] that term should be defined" and provides examples (e.g., Indonesia requires reporting at the production sharing agreement level; companies in the U.S. report royalties by lease).

547 See letter from Hermes.

548 See letter from RWI 1.

Another commentator stated that, in addition to issuers already collecting the majority of information required to be made public under Section 13(q) for internal record-keeping and audits, U.S. issuers already report such information to tax authorities at the lease and license level.[549] This commentator added that efficiently-run companies should not have to make extensive changes to their existing systems and processes to export practices undertaken in one operating environment to another.[550]

One commentator, while not providing competing estimates, questioned the accuracy of the assertions relating to costs from industry participants.[551] This commentator cited the following factors which led it to question the cost assertions from industry participants: (i) some issuers already report project-level payments in certain countries in one form or another and under a variety of regimes; (ii) some EITI countries are already moving toward project-level disclosure; and (iii) it is unclear whether issuers can save much time or money by reporting government payments at the material project or country level.[552] This commentator also explained that issuers must keep records of their subsidiaries' payments to governments as part of the books and records provisions of the Foreign Corrupt Practices Act, so the primary costs of reporting these payments will be in the presentation of the data rather than

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549 See letter from PWYP 1.

550 See letter from PWYP 1 (citing statement made by Calvert Investments at a June 2010 IASB-sponsored roundtable).

551 See letter from ERI 2.

552 See id.

any need to institute new tracking systems.[553] This commentator indicated that to the extent that issuers may need to implement new accounting and reporting systems to keep track of government payments, then issuers presumably will need to develop mechanisms for receiving and attributing information on individual payments regardless of the form the final rules take.[554] The commentator also observed that the proposed rules simply would require companies to provide the payment information in its raw form, rather than requiring them to process it and disclose only those payments from projects they deem to be "material," which could result in savings to issuers of time and money by allowing them to submit data without having to go through a sifting process.[555] This commentator observed that none of the commentators who submitted cost estimates attempted to quantify the savings that would "supposedly accrue" if disclosure were limited to "material" projects, as compared to disclosure of all projects, and noted that the Commission was not required to accept commentators' bare assertions that their "marginal costs would be reduced very significantly."[556]

One commentator disagreed that issuers already report the payment information required by Section 13(q) for tax purposes.[557] According to that commentator, "[t]his is a simplistic view, and the problem is that tax payments for a specific year are not necessarily

553 See id.

554 See id.

555 See id.

556 See id.

557 See letter from Rio Tinto.

based on the actual accounting results for that year."[558] This commentator also noted that tax reporting and payment periods may differ.[559]

Some commentators suggested that the statutory language of Section 13(q) gives the Commission discretion to hold individual company data in confidence and to use that data to prepare a public report consisting of aggregated payment information by country.[560] Other commentators strongly disagreed with the interpretation that Section 13(q) could be read not to require the public disclosure of the payment information submitted in annual reports and that the Commission may choose to make public only a compilation of the information.[561] The commentators suggesting the Commission make public only a compilation of information submitted confidentially by resource extraction issuers argued such an approach would address many of their concerns regarding disclosure of commercially sensitive or legally prohibited information and would significantly mitigate the costs of the mandatory disclosure under Section 13(q). As noted above, we have not taken this approach in the final rules because we believe Section 13(q) requires resource extraction issuers to provide the payment disclosure publicly and does not contemplate confidential submissions of the required information. As a result, the final rules require public disclosure of the information. We note that in situations involving more than one payment, the information will be

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558 See id.

559 See id.

560 See note 381 and accompanying text.

561 See letters from Calvert, PWYP 1, RWI 1, Sen. Cardin et al. 1, Sen. Cardin et al. 2, and Sen. Levin 1.

aggregated by payment type, government, and/or project, and therefore may limit the ability of competitors to use the information to their advantage.

To the extent public disclosure of this information could result in costs related to competitive concerns, we note that even if we permitted issuers to provide the information confidentially to us and we were to publish a compilation of the information, interested parties might still be able to obtain the information pursuant to the Freedom of Information Act (FOIA).[562] Section 13(q) does not state that it provides any special protection from FOIA disclosure for information required to be submitted. Thus, the same competitive concerns could still exist.

One commentator expressed concerns with the proposed requirement to prepare the payment disclosures on the cash-basis of accounting, and noted that because registrants' existing reporting processes and accounting systems are based on the accrual method of accounting (and require certain payments to be capitalized), the proposal would impose a burden on resource extraction issuers' accounting groups to develop new information system, processes, and controls.[563]

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562 FOIA requires all federal agencies to make specified information available to the public, including the information required to be filed publicly under our rules. To the extent that the information required to be filed does not fall within one of the exemptions in FOIA (e.g., FOIA provides an exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential"; 5 U.S.C. 552(b)(4)) the information required to be filed would not be protected from FOIA disclosure.

563 See letter from PWC.

Several commentators stated that the Commission should define "not de minimis" to mean material.[564] According to those commentators, a definition based on materiality would be consistent with the EITI and the Commission's longstanding disclosure regime, and would encourage consistency of disclosure across issuers.[565] Although a materiality-based definition might result in reduced compliance costs for issuers, we continue to believe that given the use of the phrase "not de minimis" in Section 13(q) rather than use of a materiality standard, which is used elsewhere in the federal securities laws and in the EITI,[566] "not de minimis" does not equate to a materiality standard.

Consistent with Section 13(q), the final rules require resource extraction issuers to disclose payments made by a subsidiary or entity under the control of the issuer. Some commentators suggested that we limit the requirement to disclose only those payments made by an issuer and its subsidiaries for which consolidated financial information is provided. Although limiting the requirement might result in reduced compliance costs for issuers, we do not believe it would be appropriate to do so because the statute specifically states that resource extraction issuers must disclose payments made by subsidiaries and entities under the control of the issuer.

The final rules clarify that the term "foreign government" includes foreign subnational governments and define the term to explicitly include both a foreign national government as well as a foreign subnational government, such as the government of a state,

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564 See note 224 and accompanying text.

565 See notes 225 and 226 and accompanying text.

566 See note 251 and accompanying text.

province, county, district, municipality, or territory under a foreign national government. Thus, resource extraction issuers will be required to provide information about payments made to foreign subnational governments. This broad definition may increase disclosure costs compared to a less detailed definition, but we believe Section 13(q) requires this broader definition, because Section 13(q) defines the term "foreign government" and requires issuers to include an electronic tag identifying the government that received the payments, and the country in which the government is located. The statutory requirement to provide electronic tags for both the government that received the payments and the country in which the government is located indicates that the intent of the statute is to include foreign subnational governments in the definition of "foreign governments." This clarification should further the statutory goal of increasing transparency with regard to the payments made to foreign governments.

In addition to direct compliance costs, we expect that the statute could result in significant economic effects. Issuers that have a reporting obligation under Section 13(q) could be put at a competitive disadvantage with respect to private companies and foreign companies that are not subject to the reporting requirements of the United States federal securities laws and therefore do not have such an obligation. For example, such competitive disadvantage could result from, among other things, any preference by the government of the host country to avoid disclosure of covered payment information, or any ability of market participants to use the information disclosed by reporting issuers to derive contract terms, reserve data, or other confidential information. With respect to the latter concern, the potential anti-competitive effect of the required disclosures may be tempered because, under the statute, only the amount of covered payments needs to be disclosed, not the manner in which such payments are determined or other contract terms. Some commentators have stated that confidential production and reserve data can be derived by competitors or other interested persons with industry knowledge by extrapolating from the payment information required to be disclosed.[567] Other commentators have argued, however, that such extrapolation is not possible, and that information of the type required to be disclosed by Section 13(q) would not confer a competitive advantage on industry participants not subject to such disclosure requirements.[568] Any competitive impact of Section 13(q) should be minimal in those jurisdictions in which payment information of the types covered by Section 13(q) is already publicly available.[569] In addition, the competitive impact may be reduced to the extent that other jurisdictions, such as the EU, adopt laws to require disclosure similar to the disclosure required by Section 13(q) and the related rules.[570] If the requirement to disclose payment information does impose a competitive disadvantage on an issuer, such issuer possibly may be incented to sell assets affected by such competitive disadvantage at a

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567 See letters from API 1, ExxonMobil 1, and RDS 1.

568 See letters from PWYP 1 and Oxfam 1.

569 PWYP provides examples of countries in which payments are publicly disclosed on a lease or concession level. See letter from PYWP 3.

570 One commentator suggested that if both the US and EU implement disclosure requirements regarding payments to governments "around 90% of the world's extractive companies will be covered by the rules." See letter from Arlene McCarthy (August 10, 2012)(Arlene McCarthy is a member of the European Parliament and the parliamentary draftsperson on the EU transparency rules for the extractive sector).

price that does not fully reflect the value of such assets, absent such competitive impact.[571] Additionally, resource extraction issuers operating in countries which prohibit, or may in the future prohibit, the disclosure required under the final rules could bear substantial costs.[572] Such costs could arise because issuers may have to choose between ceasing operations in certain countries or breaching local law, or the country's laws may have the effect of preventing them from participating in future projects. Some commentators asserted that four countries currently have such laws,[573] although other commentators disputed the assertion that there are foreign laws that specifically prohibit disclosure of payment information.[574] A foreign private issuer with operations in a country that prohibits disclosure of covered payments, or foreign issuer that is domiciled in such country, might face different types of costs – it might decide it is necessary to delist from an exchange in the United States, deregister, and cease reporting with the Commission,[575] thus incurring a higher cost of capital and potentially limited access to capital in the future. In addition, it is possible that more countries will adopt laws prohibiting the disclosure required by the final rules. Shareholders,

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571 For example, a study on divestitures of assets finds that companies that undertake voluntary divestitures have positive stock price reactions but finds that companies forced to divest assets due to action undertaken by the antitrust authorities suffer a decrease in shareholder value. See Kenneth J. Boudreaux, "Divestiture and Share Price." Journal of Financial and Quantitative Analysis 10 (September 1975), 619-26. G. Hite and J. Owers. "Security Price Reactions around Corporate Spin-Off Announcements." Journal of Financial Economics 12 (December 1983), 409-36 (finding that firms spinning off assets because of legal/regulatory difficulties experience negative stock returns).

572 See notes 52 and 53 and accompanying text.

573 See letters from API 1 and ExxonMobil 1. See also letter from RDS 1 (mentioning China, Cameroon, and Qatar).

574 See, e.g., letters from ERI 3, Global Witness 1, PWYP 1, PWYP 3, and Rep. Frank et al.

575 See letter from Berns.

including U.S. shareholders, might suffer an economic and informational loss if an issuer decides it is necessary to deregister and cease reporting under the Exchange Act in the United States.

Addressing other potential costs, one commentator referred to a potential economic loss borne by shareholders, without quantifying such loss, which the commentator believed could result from highly disaggregated disclosures of competitively sensitive information causing competitive harm.[576] The commentator also noted resource extraction issuers could suffer competitive harm because they could be excluded from many future projects altogether.[577] Another commentator noted that tens of billions of dollars of capital investments would potentially be put at risk if issuers were required to disclose, pursuant to our rules, information prohibited by the host country's laws or regulations.[578] One commentator also noted that because energy underlies every aspect of the economy, these negative impacts have repercussions well beyond resource extraction issuers.[579]

As discussed above, several commentators suggested that we adopt exemptions or modify the disclosure requirements to mitigate the adverse impact of the Section 13(q) reporting requirement.[580] One commentator indicated that the final rules should be "aligned and coordinated" with the process being developed by the DOI to fulfill the United States'

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576 See letter from API 1.

577 See id.

578 See letter from RDS 4.

579 See letter from API 1.

580 See, e.g., notes 50, 60, and 66 and accompanying text.

commitment to implementing the EITI.[581] We considered alternatives to the approach we are adopting in the final rules, including providing certain exemptions from the disclosure requirements mandated by Section 13(q), but we believe that adopting any of the alternatives would be inconsistent with Section 13(q) and would undermine Congress' intent to promote international transparency efforts. In Section 13(q) Congress mandated that we adopt rules with a specific scope and features (e.g., "not de minimis" threshold, project level reporting, and electronic tagging). To faithfully effectuate Congressional intent, we do not believe it would be appropriate to adopt provisions that would frustrate, or otherwise be inconsistent with, such intent. Consequently, we believe the competitive burdens arising from the need to make the required disclosures under the final rules are necessary by the terms of, and in furtherance of the purposes of, Section 13(q).

A number of factors may serve to mitigate the competitive burdens arising from the required disclosure. We note there were differences in opinion among commentators as to the applicability of host country laws.[582] Moreover, the widening global influence of the EITI and the recent trend of other jurisdictions to promote transparency, including listing requirements adopted by the Hong Kong Stock Exchange and proposed directive of the

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581 See letter from NMA 3. See also note 14. Referring to Executive Orders 13563 and 13610, the commentator suggested that we align the final rules with the process being developed by DOI so that "extractive industries are not subject to contradictory or overlapping reporting processes." As we have described above, the final rules are generally consistent with the EITI, except where the language of Section 13(q) clearly deviates from the EITI. In these instances, the final rules generally track the statute because, on these specific points, we believe the statutory language demonstrates that Congress intended the final rules to go beyond what is required by the EITI. In this regard, we view the reporting regime mandated by Section 13(q) as being complementary to, rather than duplicative of, host country transparency initiatives implemented under the EITI.

582 See note 84.

European Commission, may discourage governments in resource-rich countries from adopting new prohibitions on payment disclosure.[583] Reporting companies concerned that disclosure required by Section 13(q) may be prohibited in a given host country may also be able to seek authorization from the host country in order to disclose such information, reducing the cost to such reporting companies resulting from the failure of Section 13(q) to include an exemption for conflicts with host country laws.[584] Commentators did not provide estimates of the cost that might be incurred to seek such an authorization.

Not providing any exemptions should improve the transparency of the payment information because users of the Section 13(q) disclosure can obtain more information about payments than would otherwise be the case if the final rules provided an exemption. To the extent that other jurisdictions are developing and planning to adopt similar initiatives (e.g., EU), the advantage to foreign companies not listed in the U.S. might diminish over time. Further, not providing any exemptions also improves the comparability of payment information among resource extraction issuers and across countries. As such, it may increase the benefit to users of the Section 13(q) disclosure. In addition, in light of the absence of an exemption from the disclosure requirement for foreign laws that prohibit the payment disclosure, countries may be less incentivized to enact laws prohibiting the disclosure.

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583 See notes 15 and 48.

584 The Angola Order indicates that the Minister of Petroleum may provide formal authorization for the disclosure of information regarding a reporting company's activities in Angola. See letter from ExxonMobil 2. See also letter from PWYP 2 ("Current corporate practice suggests that the Angolan government regularly provides this authorization. For instance, Statoil regularly reports payments made to the Angolan government." (internal citations omitted)). The legal opinions submitted by Royal Dutch Shell with its comment letter also indicate that disclosure of otherwise restricted information may be authorized by government authorities in Cameroon and China, respectively. See letter from RDS 2.

Unlike many of the Commission's rulemakings, the compliance costs imposed by disclosure requirement mandated by Section 13(q) are intended to achieve social benefits. As noted above, the cost of compliance for this provision will be borne by the shareholders of the company thus potentially diverting capital away from other productive opportunities which may result in a loss of allocative efficiency.[585] Such effects may be partially offset if increased transparency of resource extraction payments reduces rent-seeking behavior by governments of resource-rich countries and leads to improved economic development and higher economic growth. A number of economic studies have shown that reducing corruption results in higher economic growth through more private investments, better deployment of human capital, and political stability.[586]

### C. Benefits and Costs Resulting from Commission's Exercise of Discretion

As discussed in detail in Section II, we have revised the rules from the Proposing Release to address comments we received while remaining faithful to the language and intent of the statute as adopted by Congress. In addition to the statutory benefits and costs noted above, we believe that the use of our discretion in implementing the statutory requirements will result in a number of benefits and costs to issuers and users of the payment information. We discuss below the choices we made in implementing the statute and the associated

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585 See letter from Chevron; see also letter from Chairman Bachus and Chairman Miller.

586 See Paolo Mauro, "Corruption and Growth." Quarterly Journal of Economics. 110, 681–712 (1995); Pak Hung Mo, "Corruption and Economic Growth." Journal of Comparative Economics 29, 66–79 (2001); K. Gyimah-Brempong, "Corruption, economic growth, and income inequality in Africa", Economics of Governance 3, 183-209(2002); K. Blackburn, N. Bose, and E.M. Haque, "The Incidence and Persistence of Corruption in Economic Development", Journal of Economic Dynamics and Control 30, 2447-2467(2006); Pierre-Guillaume Méon and Khalid Sekkat, "Does corruption grease or sand the wheels of growth?", Public Choice 122, 69–97(2005).

benefits and costs. We are unable to quantify the impact of each of the decisions we discuss below with any precision because reliable, empirical evidence regarding the effects is not readily available to the Commission. Thus, in this section, our discussion on the costs and benefits of our individual discretionary choices is qualitative. In Section III.D. below, we present a quantified analysis on the overall costs of the final rules that include all aspects of the implementation of the statute.

#### 1. Definition of "Commercial Development of Oil, Natural Gas, or Minerals"

Consistent with the proposal, the final rules define "commercial development of oil, natural gas, or minerals" to include exploration, extraction, processing, and export, or the acquisition of license for any such activity. As described above, the final rules we are adopting generally track the language in the statute, and except for where the language or approach of Section 13(q) clearly deviates from the EITI, the final rules are consistent with the EITI. In instances where the language or approach of Section 13(q) clearly deviates from the EITI, the final rules track the statute rather than the EITI. The definition of "commercial development" in Section 13(q) sets forth a clear list of activities that appears to include activities beyond what is currently contemplated by the EITI, and thus, clearly deviates from the EITI. Therefore, we believe the definition of the term in the final rules should be consistent with Section 13(q). The final rules we are adopting do not include additional activities, such as transportation or marketing, because those activities are not included in Section 13(q) and because the EITI does not explicitly include those activities. We believe defining the term in this way is consistent with Congress' goal of promoting international transparency efforts. To the extent that the definition of "commercial development" is consistent with the activities typically included in EITI programs, the final rules may promote consistency and comparability of disclosure made pursuant to Section 13(q) and the related rules and EITI programs, which may further Congress' goal of supporting international transparency promotion efforts. We recognize that limiting the definition to this list of specified activities could result in costs to users of the payment information to the extent that disclosure about additional activities, such as refining, smelting, marketing, or stand-alone transportation services (that is, transportation that is not otherwise related to export), would be useful to users of the information.

As noted above, to promote the goals of the provision, the final rules include an anti-evasion provision that requires disclosure with respect to an activity or payment that, although not in form or characterization one of the categories specified under the final rules, is part of a plan or scheme to evade the disclosure required under Section 13(q).[587] Under this provision, a resource extraction issuer could not avoid disclosure, for example, by re-characterizing an activity that would otherwise be covered under the final rules as transportation. We recognize that adding this requirement may increase the compliance costs for some issuers; however, we believe this provision is appropriate in order to minimize evasion and improve the effectiveness of the disclosure, thereby furthering Congress' goal.

We considered requiring disclosure about additional activities such as refining, smelting, marketing, or stand-alone transportation services, but determined not to include

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587 See Instruction 9 to Item 2.01 of Form SD.

those activities in the definition of "commercial development" for the reasons described above and because it would unnecessarily increase compliance costs for issuers. We also considered adopting a definition of "commercial development" that omitted one or more of the statutorily-listed activities, such as "export," as some commentators had suggested.[588] We decided against that alternative because, although it might result in less costs for issuers, the plain language of Section 13(q) does not support that approach.

In response to commentators' request for clarification of the activities covered by the final rules, we also are providing guidance about the activities covered by the terms "extraction," "processing," and "export." The guidance should reduce uncertainty about the scope of the activities that give rise to disclosure obligations under Section 13(q) and the related rules, and therefore should facilitate compliance and help to lessen the costs associated with the disclosure requirements.

### 2. Types of Payments

In the final rules we added two additional categories of payments to the list of payment types that must be disclosed – dividends and payments for infrastructure improvements. We included these payment types in the final rules because, based on the EITI and the comments we received on the proposal, we believe they are part of the commonly recognized revenue stream.[589] Defining the term "payment" to include

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588 See, e.g., letters from API 1 and ExxonMobil 1.

589 See notes 164, 176, and 177 and accompanying text.

dividends[590] and payments for infrastructure improvements (e.g., building a road) in the list of payment types required to be disclosed under the final rules should promote consistency with EITI reporting and improve the effectiveness of the disclosure, thereby furthering Congress' goal of supporting international transparency promotion efforts. Defining "payment" to include dividends and payments for infrastructure improvements also could help alleviate competitiveness concerns by imposing similar disclosure requirements on issuers that make such payments and issuers that make other types of payments, such as royalties, production entitlements, or fees, required to be disclosed under the final rules.

As discussed earlier, resource extraction issuers will incur costs to provide the payment disclosure for the payment types identified in the statute, such as the costs associated with modifications to the issuers' core enterprise resource planning systems and financial reporting systems to capture and report the payment data at the project level, for each type of payment, government payee, and currency of payment.[591] The addition of dividends and payments for infrastructure improvements to the list of payment types for which disclosure is required may increase some issuers' costs of complying with the final rules. For example, issuers may need to add these types of payments to their tracking and reporting systems. We understand that these types of payments are more typical for mineral

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590 The final rules generally do not require the disclosure of dividends paid to a government as a common or ordinary shareholder of the issuer as long as the dividend is paid to the government under the same terms as other shareholders. The issuer will be required to disclose dividends paid to a government in lieu of production entitlements or royalties. See Instruction 7 to Item 2.01 of Form SD.

591 See note 529 and accompanying text.

extraction issuers than for oil firms,[592] and therefore only a subset of the issuers subject to the final rules might be affected.

The final rules do not require disclosure of certain other types of payments, such as social or community payments. We recognize that excluding those payments reduces the overall level of disclosure; however, we have not included those payments as required payment types under the final rules because commentators disagreed as to whether they are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals and the EITI does not require the disclosure of social or community payments.[593] In addition, by not including these types of payments, the final rules should benefit issuers by avoiding additional compliance costs for disclosure that does not clearly enhance the effectiveness of the disclosure required under Section 13(q).

Resource extraction issuers that predominantly make payments that must be disclosed pursuant to the final rules may be at a competitive disadvantage as compared to resource extraction issuers that predominately make payments that are not identified in the final rules. To the extent that other types of payments could be used to substitute for explicitly defined payments, resource extraction issuers may try to circumvent the required disclosures by shifting to other, not explicitly defined payments, and away from the types of payments listed

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592 See, e.g., letters from PWYP 1 and Global Witness 1; see also Chapter 19 "Advancing the EITI in the Mining Sector: Implementation Issues" by Sefton Darby and Kristian Lempa, in Advancing the EITI in the Mining Sector: A Consultation with Stakeholders (EITI 2009).

593 See note 185 and accompanying discussion, above (citing commentators suggesting that social or community payments constitute part of the commonly recognized revenue stream of resource extraction) and note 188 and accompanying discussion, above (citing commentators maintaining that social or community payments are not part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals).

in the final rules. This could have the effect of reducing the transparency contemplated by the statute. For example, the exclusion of social or community payments might encourage issuers to mask other payments, such as infrastructure improvement payments, as social or community payments to avoid reporting under the rules, limiting the effectiveness of the disclosure. As noted above, to promote the goals of Section 13(q), the final rules include an anti-evasion provision that requires disclosure with respect to an activity or payment that, although not in form or characterization of one of the categories specified under the final rules, is part of a plan or scheme to evade the disclosure required under Section 13(q).[594] Under this provision, a resource extraction issuer could not avoid disclosure, for example, by re-characterizing or re-configuring a payment as one that is not required to be disclosed. We considered, as an alternative to an anti-evasion provision, defining terms broadly to cover a wider range of activities, but determined that more expansive definitions could increase compliance costs for resource extraction issuers and that an anti-evasion provision should result in lower compliance costs and would accomplish the statute's transparency goals.

As discussed above, the final rules clarify that the term "fees" includes license fees, rental fees, entry fees, and other considerations for licenses or concessions, and the term "bonuses" includes signature, discovery, and production bonuses. In addition, the final rules clarify that a resource extraction issuer will be required to disclose payments for taxes levied on corporate profits, corporate income, and production, but will not be required to disclose payments for taxes levied on consumption, such as value added taxes, personal income taxes, or sales taxes. These clarifications are consistent with the EITI and, therefore, should help

594 See Instruction 9 to Item 2.01 of Form SD.

promote comparability and support international transparency promotion efforts. Moreover, these clarifications should benefit issuers by reducing uncertainty about the types of payments required to be disclosed under Section 13(q) and the related rules, and therefore should facilitate compliance and help mitigate costs. On the other hand, inclusion of these specific types of fees, taxes, and bonuses could increase compliance costs for issuers, particularly for issuers that have not participated in an EITI program and would not track or report these items except for our clarification.

Under the final rules, issuers may disclose payments that are made for obligations levied at the entity level, such as corporate income taxes, at that level rather than the project level. This accommodation should help reduce compliance costs for issuers without interfering with the goal of achieving increased payment transparency.

Under the final rules, issuers must disclose payments made in-kind. This requirement is consistent with the EITI and should help further the goal of supporting international transparency promotion efforts and enhance the effectiveness of the disclosure. We have provided issuers with some flexibility in reporting in-kind payments. Resource extraction issuers may report in-kind payments at cost, or if cost is not determinable, at fair market value, which we believe should facilitate compliance with Section 13(q) and potentially lower compliance costs. This requirement could impose costs to the extent that issuers have not previously had to value their in-kind payments, or they use a different method to value those payments.

### 3. Definition of "Not De Minimis"

Section 13(q) requires the disclosure of payments that are "not de minimis," but leaves the term "not de minimis" undefined. In the final rules we define "not de minimis" to mean any payment, whether made as a single payment or a series of related payments, that equals or exceeds $100,000. Although we considered leaving "not de minimis" undefined, as we had proposed, we were convinced by commentators that defining this term should help to promote consistency in payment disclosures and reduce uncertainty about what payments must be disclosed under Section 13(q) and the related rules, and therefore should facilitate compliance.[595] As noted above, because the primary purpose of Section 13(q) is to further international transparency efforts regarding payments to governments for the commercial development of oil, natural gas, or minerals, we believe that whether a payment is "not de minimis" should be considered in relation to a host country. We recognize that issuers may have difficulty assessing the significance of particular payments for particular countries or recipient governments; therefore, we are adopting a $100,000 threshold that we believe will provide clear guidance about payments that are "not de minimis" and promote the transparency goals of the statute.

We considered adopting a definition of "not de minimis" that was based on a qualitative principle or a relative quantitative measure rather than an absolute quantitative

595 See notes 223 and 231-233 and accompanying text.

standard.[596] We chose the absolute quantitative approach for several reasons. An absolute quantitative approach will promote consistency of disclosure and, in addition, will be easier for issuers to apply than a definition based on either a qualitative principle or relative quantitative measure.[597] Moreover, using an absolute dollar amount threshold for disclosure purposes should also reduce compliance costs by reducing the work necessary to determine what payments must be disclosed.

Therefore, in choosing the "de minimis" amount, we selected an amount that we believe strikes an appropriate balance in light of varied commentators' concerns and the purpose of the statute. Although some commentators suggested various thresholds,[598] no commentator provided data to assist us in determining an appropriate threshold amount.

We considered other absolute amounts but chose $100,000 as the quantitative threshold in the definition of "not de minimis." We decided not to adopt a lower threshold because we are concerned that such an amount could result in undue compliance burdens and raise competitive concerns for many issuers. As previously noted, we believe a $100,000 threshold is more appropriate than, and an acceptable compromise to, the amounts suggested by commentators because it furthers the purpose of Section 13(q) and may result in a lesser compliance burden than otherwise would be the case if a lower threshold was used.[599] In

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596 As previously noted, we declined to adopt a "not de minimis" definition based on a materiality principle because that alternative is not supported by the language of Section 13(q). See note 566 and accompanying text.

597 See note 252 and accompanying text.

598 See notes 235-243 and accompanying text.

599 See notes 257-267 and accompanying text.

addition, to prevent issuers from breaking down their payments into amounts smaller than $100,000 and thus avoiding disclosure, we provide an instruction in the final rules noting that in the case of any arrangement providing for periodic payments or installments of the same type, a resource extraction issuer must consider the aggregate amount of the related periodic payments or installments of the related payments in determining whether the payment threshold has been met for that series of payments, and accordingly, whether disclosure is required.

We also considered defining "not de minimis" in terms of a materiality standard, which would generally suggest, consistent with commentators views, a threshold larger than $100,000. Such an alternative would likely have resulted in lower compliance costs for issuers. We also could have chosen to use a larger number, such as $1,000,000, to define "not de minimis," which again would have resulted in lower compliance costs. Although a "not de minimis" definition based on a materiality standard, or a much higher amount, such as $1,000,000, could lessen competitive concerns, setting the threshold too high could leave important payment streams undisclosed, reducing the potential benefits to be derived from Section 13(q). In addition, we believe that use of the term "not de minimis" in Section 13(q) indicates that a threshold quite different from a materiality standard and significantly less than $1,000,000 is necessary to further the transparency goals of the statute. While the $100,000 threshold may result in some smaller payments not being reported, we believe this threshold strikes an appropriate balance between concerns about the potential compliance burdens of a lower threshold and the need to fulfill the statutory directive for resource extraction issuers to disclose payments that are "not de minimis."

### 4. Definition of "Project"

Section 13(q) requires a resource extraction issuer to disclose information regarding the type and total amount of payments made to a foreign government or the Federal Government for each project relating to the commercial development of oil, natural gas, or minerals, but it does not define the term "project." As noted above, the final rules leave the term undefined, but we have provided some guidance about the term. Leaving the term "project" undefined should provide issuers some flexibility in applying the term to different business contexts depending on factors such as the particular industry or business in which the issuer operates, or the issuer's size.

As noted above, resource extraction issuers routinely enter into contractual arrangements with governments for the purpose of commercial development of oil, natural gas, or minerals. The contract defines the relationship and payment flows between the resource extraction issuer and the government, and therefore, it would serve as the basis for determining a "project." We understand that the term "project" is used within the extractive industry in a variety of contexts, and that individual issuers routinely provide disclosure about their own projects in their Exchange Act reports and other public statements. To the extent that the meaning of "project" is generally understood by resource extraction issuers and investors, leaving the term undefined should not impose undue costs.

Resource extraction issuers may incur costs in determining their "projects." Leaving the term undefined in the final rules may result in higher costs for some resource extraction issuers than others if an issuer's determination of what constitutes a "project" would result in more granular information being disclosed than another issuer's determination of what constitutes a "project." We anticipate that these costs may diminish over time as resource extraction issuers become familiar with how other resource extraction issuers determine their "projects." In addition, we recognize that leaving the term "project" undefined may not result in the transparency benefits that the statute seeks to achieve as effectively as would be the case if we adopted a definition because resource extraction issuers' determination of what constitutes a "project" may differ, which could reduce the comparability of disclosure across issuers. Inconsistent disclosure may be mitigated to some extent by the guidance we are providing about the term.

We considered defining "project" at the country level. A number of commentators asserted that this approach would further lower their compliance burdens.[600] While we recognize that approach would reduce compliance burdens for issuers, we did not adopt it because we believe it would be inconsistent with Congress' intent to provide more detailed disclosure than at the country level and would not effectively result in the transparency benefits that the statute seeks to achieve.[601] We believe the statutory requirement to provide interactive data tags identifying the government that received the payment and the country in which that government is located is further evidence that statutory reference to "project" was intended to elicit disclosure at a more granular level than country-level reporting.

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600 See letters from API 1, ExxonMobil 1, Petrobras, and RDS 1.

601 See note 313 and accompanying text.

We also considered defining "project" as a reporting unit, as suggested by some commentators.[602] We decided against that approach because we believe that requiring disclosure at the reporting unit level would be inconsistent with the use of the term "project" in Section 13(q). In this regard we note that it is not uncommon for an issuer to define a reporting unit as a geographic region (for example, as a country or continent), which would result in aggregated payment disclosure that is inconsistent with the transparency goal of the statute.

As suggested by some commentators, we considered defining "project" in relation to a particular geologic resource, such as a "geologic basin" or "mineral district."[603] We decided not to adopt this approach because, as noted by some commentators,[604] a geologic basin or mineral district may span more than one country, which would be counter to the country-by-country reporting required by Section 13(q). In addition, we understand that defining the term in this manner may not reflect how resource extraction issuers enter into contractual arrangements for the extraction of resources, which define the relationship and payment flows between the resource extraction issuer and the government. For these reasons, we believe that defining "project" as a "geologic basin" may be inconsistent with the use of the term "project" in Section 13(q) and may not result in the transparency benefits that the statute seeks to achieve.

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602 See note 283 and accompanying text.

603 See note 286 and accompanying text.

604 See note 290 and accompanying text.

In addition, we considered defining "project" by reference to a materiality standard as it is used under the federal securities laws, as suggested by some commentators.[605] While such an approach could reduce compliance burdens for issuers, we did not adopt it because we believe it would be inconsistent with Congress' intent to provide more detailed disclosure than would be provided using such a materiality standard and would not result in the transparency benefits that the statute seeks to achieve.

To comply with the final rules, a resource extraction issuer could be required to implement systems to track payments at a different level of granularity than what it currently tracks, which could result in added compliance and implementation costs. We expect, however, that to the extent resource extraction issuers' systems currently track "projects" or information by reference to its contractual arrangements, such costs should be reduced. Not defining the term "project" under the final rules could result in added compliance costs when compared to the alternative of adopting a definition suggested by some commentators. By not defining "project" as "country," "reporting unit," "geologic basin," or "material project," as some commentators suggested,[606] issuers could incur costs relating to implementation of systems to track payment information at a more granular level than what their current systems track. In addition, by leaving the term undefined rather than adopting one of the definitions suggested by commentators, the final rules may effectively require disclosure that may result in voluminous information and increase the costs to issuers to track and report.

605 See note 291 and accompanying text.

606 See notes 279, 283, 286, and 291 and accompanying text.

### 5. Annual Report Requirement

Section 13(q) provides that the resource extraction payment disclosure must be "include[d] in an annual report." The final rules require an issuer to file the payment disclosure in an annual report on new Form SD, rather than furnish it in one of the existing Exchange Act annual report forms as proposed. Form SD will be due no later than 150 days after the end of the issuer's most recent fiscal year. This should lessen the burden of compliance with Section 13(q) and the related rules because issuers generally will not have to incur the burden and cost of providing the payment disclosure at the same time that it must fulfill its disclosure obligations with respect to an Exchange Act annual report.[607] An additional benefit is that this requirement also would provide information to users in a standardized manner for all issuers rather than in different annual report forms depending on whether a resource extraction issuer is a domestic or foreign filer. In addition, requiring the disclosure in new Form SD, rather than in issuers' Exchange Act annual reports, should alleviate concerns about the disclosure being subject to the officer certifications required by Exchange Act Rules 13a-14 and 15d-14, thus potentially lowering compliance costs.

Resource extraction issuers will incur costs associated with preparing and filing new Form SD; however, we do not believe the costs associated with filing a new form to provide the disclosure instead of furnishing the disclosure in an existing form will be significant.

607 For example, a resource extraction issuer may potentially be able to save resources to the extent that the timing of its obligations with respect to its Exchange Act annual report and its obligations to provide payment disclosure allow for it to allocate its resources, in particular personnel, more efficiently.

Requiring covered issuers to file, instead of furnish, the payment information in Form SD may increase the ability of investors to bring suit, for instance under Section 18 of the Exchange Act. This may improve the avenues of redress available to investors if issuers fail to comply with the new disclosure requirements. Because this could improve investors' ability to seek redress, it is possible that resource extraction issuers may be more accountable for and more likely to make the required disclosure. This, in turn, may provide benefits to investors to the extent they use the information to make investment decisions. On the other hand, our decision to require issuers to file, rather than furnish, the payment information will potentially subject issuers to litigation under Section 18 and may cause issuers to take greater care in preparing the disclosures, thereby increasing issuers' costs of complying with the rules.[608]

Finally, some commentators noted the potential for their cost estimates to increase if the final rules required the payment information to be audited. Consistent with Section 13(q) and the proposal, the final rules do not require the resource extraction payment information to be audited or provided on an accrual basis. Not requiring the payment information to be audited or provided on an accrual basis is consistent with Section 13(q) because the statute requires the Commission to issue final rules for disclosure of payments by resource extraction issuers and, unlike the EITI, does not contemplate that an administrator will audit and reconcile the information, or produce a report as a result of the audit and reconciliation.

608 While the potential for litigation may increase costs, we note that Section 18 claims have not been prevalent in recent years and a plaintiff asserting a claim under Section 18 would need to meet the elements of the statute, including materiality, reliance, and damages. See Louis Loss and Joel Seligman, Ch. 11 "Civil Liability," Subsect. c "False Filings [§ 18]," Fundamentals of Securities Regulation (3rd Ed. 2005).

In addition, not requiring the payment information to be audited or provided on an accrual basis may result in lower compliance costs than otherwise would be the case if resource extraction issuers were required to provide the information on an accrual basis or audited information.[609] A potential cost associated with not requiring an audit is that users of the information may perceive non-audited information as less reliable than audited information.

### 6. Exhibit and Interactive Data Requirement

Section 13(q) requires the payment disclosure to be electronically formatted using an interactive data standard. Under the proposed rules, a resource extraction issuer would have been required to provide the disclosure in two exhibits – one in HTML and one in XBRL. The final rules require a resource extraction issuer to provide the required payment disclosure in one exhibit to Form SD. The exhibit must be formatted in XBRL and provide all of the electronic tags required by Section 13(q) and the final rules. We have decided to require only one exhibit formatted in XBRL because we believe that we can achieve the goal of the dual presentation with only one exhibit. Issuers will submit the information on EDGAR in XBRL format, thus enabling users of the information to extract the XBRL data, and at the same time the information will be presented in an easily-readable format by rendering the information received by the issuers.[610] We believe that requiring the information to be provided in this way may reduce the compliance burden for issuers as compared to requiring a second exhibit formatted in HTML. In addition, we believe that, to the extent requiring the

609 See note 405 and accompanying text.

610 Users of this information should be able to render the information by using software available on our website at no cost.

specified information to be presented in XBRL format promotes consistency and standardization of the information, increases the usability of the payment disclosure, and reduces compliance costs, a benefit results to both issuers and users of the information.

Our choice of XBRL as the required interactive data standard may increase compliance costs for some issuers; however, Congress expressly required interactive data tagging. The electronic formatting costs will vary depending upon a variety of factors, including the amount of payment data disclosed and an issuer's prior experience with XBRL. While most issuers are already familiar with XBRL because they currently use XBRL for their annual and quarterly reports filed with the Commission, issuers not already filing reports using XBRL (i.e. foreign private issuers that report pursuant to International Financial Reporting Standards (IFRS)) will incur some start-up costs associated with XBRL. We do not believe that the ongoing costs associated with this data tagging would be greater than filing the data in XML.

Consistent with the statute, the final rules require a resource extraction issuer to include an electronic tag that identifies the currency used to make the payments. The statute does not otherwise specify how the resource extraction issuer should present the type and total amount of payments for each project or to each government. We understand that resource extraction issuers may make payments in any number of currencies, and as a result, providing total amounts may be difficult. If multiple currencies are used to make payments for a specific project or to a government, a resource extraction issuer may choose to provide the total amount per project or per government in U.S. dollars or the issuer's reporting currency. A resource extraction issuer could incur costs associated with converting payments made in multiple currencies to U.S. dollars or its reporting currency. Given the statute's tagging requirements and requirements for disclosure of total amounts, we believe reporting in one currency is required. The final rules provide flexibility to issuers in how to perform the currency conversion, which may result in lower compliance costs because it enables issuers to choose the option that works best for them. To the extent issuers choose different options to perform the conversion, it may result in less comparability of the payment information and, in turn, could result in costs to users of the information.

### D. Quantified Assessment of Overall Economic Effects

As noted above, Congress intended that the rules issued pursuant to Section 13(q) would increase the accountability of governments to their citizens in resource-rich countries for the wealth generated by those resources.[611] In addition, commentators and the sponsors of Section 13(q) also have noted that the United States has an interest in promoting accountability, stability, and good governance.[612] Congress' goal of enhanced government accountability through Section 13(q) is intended to result in social benefits that cannot be readily quantified with any precision. We also note that while the objectives of Section 13(q) do not appear to be ones that will necessarily generate measurable, direct economic benefits to investors or issuers, investors have stated that the disclosures required by Section 13(q) have value to investors and can "materially and substantially improve investment decision

[611] See note 7 and accompanying text.

[612] See note 499 and accompanying text.

making."[613] As noted previously, the benefits are inherently difficult to quantify and thus our quantitative assessment of the overall economic effects focuses on the costs of complying with the rules.

To assess the economic impact of the final rules, we estimated the initial and ongoing costs of compliance using the quantitative information supplied by commentators using two different methods. In the first method, we estimate the cost of compliance for the average company and then multiply this number by the total number of affected issuers (1,101). In the second method, we separately estimate the costs of compliance for small issuers (issuers with less than $75 million in market capitalization) and for large issuers (issuers with $75 million or more in market capitalization). For initial compliance costs, we received estimates from Barrick Gold and ExxonMobil.[614] We use these numbers to estimate a lower and an upper bound, respectively, on initial compliance costs.

Our methodology to estimate both initial and ongoing compliance costs takes the specific company estimates from Barrick Gold and ExxonMobil and applies these costs, as a percentage of total assets, to the average issuer and small and large issuers. Both Barrick Gold and ExxonMobil are very large issuers and their compliance costs may not be representative of other types of issuers. Thus, we believe it is appropriate to scale these costs to the size of the issuer. While a portion of the compliance costs will most likely be fixed (i.e., they will not vary with the size of the issuer), we expect that a portion of those costs

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613 See letter from Calvert. See note 498 and accompanying text.

614 See letter from Barrick Gold and ExxonMobil 1. NMA also provided initial compliance hours that are similar to Barrick Gold. See letter from NMA 2.

will be variable. For example, we expect larger, multinational issuers to have more complex payment tracking systems compared to smaller, single country based issuers. Thus, in our analysis we assume that compliance costs will tend to increase with firm size. Commentators did not provide any information regarding what fraction of compliance costs would be fixed versus variable.

Barrick Gold estimated that it would require 500 hours for initial changes to internal books and records and processes, and 500 hours for ongoing compliance costs. At an hourly rate of $400,[615] this amounts to $400,000 (1,000 hours x $400) for hourly compliance costs. Barrick Gold also estimated that it would cost $100,000 for initial IT/consulting and travel costs for a total initial compliance cost of $500,000. As a measure of size, Barrick Gold's total assets as of the end of fiscal year 2009 were approximately $25 billion.[616] As a percentage of Barrick Gold's total assets, initial compliance costs are estimated to be 0.002% ($500,000/$25,075,000,000).

A similar analysis for ExxonMobil estimated initial compliance costs using its estimate of $50 million. ExxonMobil's total assets as of the end of 2009 were approximately $233 billion and the percentage of initial compliance costs to total assets is 0.021% ($50,000,000/$233,323,000,000). Therefore, the lower bound of initial compliance costs to

615 This is the rate we use to estimate outside professional costs for purposes of the PRA. Although we believe actual internal costs may be less in many instances, we are using this rate to arrive at a conservative estimate of hourly compliance costs.

616 All data on total assets is obtained from Compustat, which is a product of Standard and Poor's. In addition to considering total assets as a measure of firm size, we also considered using market capitalization. Although both measures will fluctuate, we believe that market capitalization will fluctuate more and the resulting percentage would then be sensitive to the measurement date chosen. As a result, we believe that using total assets as a measure of size is more appropriate.

total assets is 0.002% based upon estimates from Barrick Gold and the upper bound is 0.021% based upon estimates from ExxonMobil.

Below is a summary of how we calculated the initial compliance costs as a percentage of total assets:

| **Initial compliance cost estimates** | | **Calculation** |
|---|---|---|
| Total number of affected issuers | 1,101 | |
| Barrick Gold compliance costs (lower bound) | | |
| Number of hours for initial changes to internal books and records and processes | 500 | |
| Number of hours for annual compliance costs | 500 | |
| Initial number of compliance hours | 1,000 | 500+500 |
| Hourly cost | $400 | |
| | | |
| Initial hourly compliance costs | $400,000 | 1,000*$400 |
| Initial IT/consulting/travel costs | $100,000 | |
| Total initial total compliance costs | $500,000 | $400,000+$100,000 |
| | | |
| Barrack Gold's 2009 total assets (Compustat) | $25,075,000,000 | |
| **Initial compliance costs as a percentage of total assets using Barrick Gold (lower bound)** | 0.002% | $500,000/$25,075,000,000 |
| | | |
| ExxonMobil compliance costs (upper bound) | | |
| Initial compliance costs | $50,000,000 | |
| ExxonMobil's 2009 total assets (Compustat) | $233,323,000,000 | |
| **Initial compliance costs as a percentage of total assets using ExxonMobil (upper bound)** | 0.021% | $50,000,000/$233,323,000,000 |

We apply these two ratios to the average issuer (Method 1) and to small and large issuers (Method 2). In Method 1, we calculate the average total assets of all affected issuers to be approximately $4.4 billion.[617] Applying the ratio of initial compliance costs to total assets (0.002%) from Barrick Gold, we estimate the lower bound of total initial compliance costs for all issuers to be $97 million (0.002% x $4,422,000,000 x 1,101). Applying the ratio of initial compliance costs to total assets (0.021%) from ExxonMobil, we estimate the upper bound of total initial compliance costs for all issuers to be $1 billion (0.021% x $4,422,000,000 x 1,101). The table below summarizes the upper and lower bound of total initial compliance costs using Method 1:

| **Method 1: Average company compliance costs** | | **Calculation** |
|---|---|---|
| | | |
| Average total assets of all affected issuers (Compustat) | $4,422,000,000 | |
| Average initial compliance costs per issuer using Barrick Gold percentage of total assets (lower bound) | $88,440 | $4,422,000,000*0.002% |
| **Total initial compliance costs using Barrick Gold (lower bound)** | **$97,372,440** | $88,440*1,101 |
| | | |
| Average initial compliance costs per issuer using Exxon Mobil's percentage of total assets (upper bound) | $928,620 | $4,422,000,000*0.021% |
| **Total initial compliance costs using ExxonMobil (upper bound)** | **$1,022,410,620** | $928,620*1,101 |

617 We determined this average by identifying the SIC codes that will be affected by the rulemaking and then obtaining from Compustat the total assets for fiscal year 2009 of all affected issuers. We then calculated the average of those total assets.

In Method 2, we conduct a similar analysis for small and large issuers. We estimate the proportion of issuers that are small issuers (63%) and the proportion of issuers that are large issuers (37%).[618] Next, we calculate the average total assets of small issuers in 2009 ($509 million) and large issuers ($4.5 billion) and apply the ratios of initial compliance costs to total assets estimated using the estimates from Barrick Gold (lower bound) and ExxonMobil (upper bound) for each type of issuer. In this analysis, we assume that the ratio of initial compliance costs to total assets does not vary by size. Therefore, small issuers have a lower bound estimate of initial compliance costs of $7 million (0.002% x $509,000,000 x 63% x 1,101) and an upper bound of $74 million (0.021% x $509,000,000 x 63% x 1,101). Large issuers have a lower bound estimate of initial compliance costs of $37 million (0.002% x $4,504,000,000 x 37% x 1,101) and an upper bound of $385 million (0.021% x $4,504,000,000 x 37% x 1,101). The sum of these two numbers provides an estimate of $44 million ($7,061,153 + $36,704,037) for the lower bound and $460 million ($74,142,111 + $385,306,841) for the upper bound of initial compliance costs.

618 For purposes of this analysis, we classify as small issuers those whose market capitalization is less than $75 million and we classify the rest of the affected issuers as large issuers.

| | | |
|---|---|---|
| **Method 2: By small and large issuers** | | |
| Percentage of small issuers (market capitalization <$75m) | 63% | |
| Percentage of large issuers (market capitalization =>$75m) | 37% | |
| | | |
| Average total assets of small issuers in 2009 (Compustat) | $509,000,000 | |
| Average total assets of large issuers in 2009 (Compustat) | $4,504,000,000 | |
| | | |
| Initial compliance costs for average small issuer | | |
| Initial compliance costs for a small issuer using Barrick Gold (lower bound) | $10,180 | 0.002%*$509,000,000 |
| Total initial compliance costs for small issuers using Barrick Gold (lower bound) | $7,061,153 | $10,180*1,101*63% |
| Initial compliance costs for a small issuer using ExxonMobil (upper bound) | $106,890 | 0.021%*$509,000,000 |
| Total initial compliance costs for small issuers using ExxonMobil (upper bound) | $74,142,111 | $106,890*1,101*63% |
| | | |
| Initial compliance costs for average large issuer | | |
| Initial compliance costs for a large issuer using Barrick Gold (lower bound) | $90,080 | 0.0020%*4,504,000,000 |
| Total initial compliance costs for large issuers using Barrick Gold (lower bound) | $36,695,890 | $90,080*1,101*37% |
| | | |
| Initial compliance costs for a large issuer using ExxonMobil (upper bound) | $945,840 | 0.021%*4,504,000,000 |
| Total initial compliance costs for large issuers using ExxonMobil (upper bound) | $385,306,841 | $945,840*1,101*37% |
| | | |
| **Total initial compliance costs for small and large issuers using Barrick Gold (lower bound)** | **$43,757,043** | $7,061,153+$36,695,890 |
| **Total initial compliance costs for small and large issuers using ExxonMobil (upper bound)** | **$459,448,952** | $74,142,111+$385,306,841 |

In summary, using the two methods, the range of initial compliance costs is as follows:[619]

| Initial compliance costs | Method 1: Average issuer analysis | Method 2: Small and large issuer analysis |
|---|---|---|
| Using Barrick Gold (lower bound) | $97,372,440 | $43,757,043 |
| Using ExxonMobil (upper bound) | $1,022,410,620 | $459,448,952 |

We acknowledge limitations on our analysis. First, the analysis is limited to two large issuers' estimates from two different industries, mining and oil and gas, and the estimates may not accurately reflect the initial compliance costs of all affected issuers. Second, we assume that compliance costs are a constant fraction of total assets, but there may be substantial fixed costs to compliance that are underestimated by using a variable cost analysis. Third, commentators mentioned other potential compliance costs not necessarily captured in this discussion of compliance costs.[620] Because of these limitations, we believe that total initial compliance costs for all issuers are likely to be near the upper bound of

619 The total estimated compliance cost for PRA purposes is $234,829,000 ([332,164 hrs * $400/hr] + $101,963,400). The compliance costs for PRA purposes would be encompassed in the total estimated compliance costs for issuers. As discussed in detail below, our PRA estimate includes costs related to tracking and collecting information about different types of payments across projects, governments, countries, subsidiaries, and other controlled entities. The estimated costs for PRA purposes are calculated by treating compliance costs as fixed costs, so despite using similar inputs for calculating compliance costs under Methods 1 and 2 above, the PRA estimate differs from the lower and upper bounds calculated above. The PRA estimate is, however, within the range of total compliance costs estimated using commentators' data.

620 Those could include, for example, costs associated with the termination of existing agreements in countries with laws that prohibit the type of disclosure mandated by the rules, or costs of decreased ability to bid for projects in such countries in the future, or costs of decreased competitiveness with respect to non-reporting entities. Commentators generally did not provide estimates of such costs. As discussed further below, we have attempted to estimate the costs associated with potential foreign law prohibitions on providing the required disclosure. See Section III.D.

approximately $1 billion. This estimate is consistent with two commentators' qualitative estimates of initial implementation costs.[621]

We also estimated ongoing compliance costs using the same two methods. We received quantitative information from three commentators, Rio Tinto, National Mining Association, and Barrick Gold, that we used in the analysis. Rio Tinto estimated that it would take between 5,000 and 10,000 hours per year to comply with the requirements, for a total ongoing compliance cost of between $2 million (5,000*$400) and $4 million (10,000*$400). We use the midpoint of their estimate, $3 million, as their expected ongoing compliance cost. The National Mining Association (NMA), which represents the mining industry, estimated that ongoing compliance costs would be 10 times our initial estimate, although it did not state specifically the number to which it referred. We believe NMA was referring to our proposed estimate of $30,000.[622] Although this is the dollar figure for total costs, NMA referred to it when providing an estimate of ongoing costs, so we do the same here, which would result in $300,000 (10*$30,000). Finally, Barrick Gold estimated that it would take 500 hours per year to comply with the requirements, or $200,000 (500*$400) per year. As with the initial compliance costs, we calculate the ongoing compliance cost as a percentage of total assets. Rio Tinto's total assets as of the end of fiscal year 2009 were approximately $97 billion and their estimated ongoing compliance costs as a percentage of assets is 0.003% ($3,000,000/$97,236,000,000). We calculated the average total assets of the

621 See letters from API 1 and ExxonMobil 1. "Total industry costs just for the initial implementation could amount to hundreds of millions of dollars even assuming a favorable final decision on audit requirements and reasonable application of accepted materiality concepts."

622 The $30,000 estimate was calculated as follows: [(52,931*$400) + $11,857,600]/1,101 = $30,000.

mining industry to be $1.5 billion,[623] and using NMA's estimated ongoing compliance costs, we estimate ongoing compliance costs as a percentage of assets of 0.02% ($300,000/$1,515,000,000). Barrick Gold's total assets as of the end of fiscal year 2009 were approximately $25 billion and their estimated ongoing compliance costs as a percentage of assets is 0.0008% ($200,000/$25,075,000,000). We then average the percentage of ongoing compliance costs to get an estimate of 0.0079% of total assets.

[623] We estimated this number by selecting only mining issuers, based on their SIC codes, obtaining their total assets as of the end of fiscal year 2009 from Compustat, and averaging the total assets of those issuers.

| Ongoing compliance costs | | Calculation |
|---|---|---|
| Rio Tinto estimate of yearly compliance costs | $2,000,000-$4,000,000 | (5,000-10,000)*$400 |
| Average Rio Tinto estimate | $3,000,000 | |
| Rio Tinto's 2009 total assets (Compustat) | $97,236,000,000 | |
| Ongoing compliance costs as a percentage of Rio Tinto's total assets | 0.003% | $3,000,000/$97,236,000,000 |
| | | |
| NMA estimate of 10 times SEC estimate in proposing release | $300,000 | 10*$30,000 |
| Average total assets for all mining issuers (Compustat) | $1,515,000,000 | |
| Ongoing compliance costs as a percentage of all mining issuers total assets (NMA) | 0.02% | $300,000/$1,515,000,000 |
| | | |
| Barrick Gold estimate of 500 hours per year | $200,000 | 500*$400 |
| Barrick Gold's 2009 total assets (Compustat) | $25,075,000,000 | |
| Ongoing compliance costs as a percentage of Barrick Gold's total assets | 0.0008% | $200,000/$25,075,000,000 |
| | | |
| **Average ongoing compliance costs as a percentage of total assets for all three estimates: Rio Tinto, NMA and Barrick Gold** | 0.0079% | |

We use the same two methods used to estimate initial compliance costs to estimate ongoing compliance costs: Method 1 for the average affected issuer and Method 2 for small and large issuers separately. In Method 1, we take the average total assets for all affected issuers, $4,422,000,000, and multiply it by the average ongoing compliance costs as a percentage of total assets (0.0079%) to get total ongoing compliance costs of approximately $385 million.

| Method 1: Average company ongoing compliance costs | | Calculation |
|---|---|---|
| | | |
| Average 2009 total assets of all affected issuers (Compustat) | $4,422,000,000 | |
| Average ongoing compliance costs per issuer using average percentage of total assets (lower bound) | $349,338 | 0.0079%*$4,422,000,000 |
| **Total ongoing compliance costs** | **$384,621,138** | $349,338*1,101 |

In Method 2, we estimate ongoing compliance costs separately for small and large issuers using the same proportion of issuers as in the analysis on initial compliance costs: small issuers (63%) and large issuers (37%). For small issuers, we take the average total assets in 2009 ($509,000,000)[624] and multiply it by the average ongoing compliance costs as a percentage of total assets (0.0079%) to get total ongoing compliance costs of approximately $28 million. For large issuers, we take the average total assets in 2009 ($4,504,000,000)[625] and multiply it by the average ongoing compliance costs as a percentage of total assets (0.0079%) to get total ongoing compliance costs of approximately $145 million. The sum of these two numbers provides an estimate of $173 million ($27,891,556 + $144,948,764) for

624 We calculate this number by selecting all small issuers according to our classification scheme (market capitalization less than or equal to $75 million) and then averaging their total assets as of the end of fiscal year 2009.

625 We calculate this number by selecting all large issuers according to our classification scheme (market capitalization $75 million or more) and then averaging their total assets as of the end of fiscal year 2009.

total ongoing compliance costs for affected issuers. Comparing these two methods suggests that the ongoing compliance costs are likely to be between $200 million and $400 million.

| **Method 2: By small and large issuers** | | |
|---|---|---|
| Percentage of small issuers (market capitalization < $75m) | 63% | |
| Percentage of large issuers (market capitalization => $75m) | 37% | |
| | | |
| Average total assets of small issuers in 2009 (Compustat) | $509,000,000 | |
| Average total assets of large issuers in 2009 (Compustat) | $4,504,000,000 | |
| | | |
| Yearly ongoing compliance costs for a small issuer | $40,211 | 0.0079%*$509,000,000 |
| Total yearly ongoing compliance costs for small issuer | $27,891,556 | $40,211*1,101*63% |
| | | |
| Yearly ongoing compliance costs for a large issuer | $355,816 | 0.0079%*$4,504,000,000 |
| Total yearly ongoing compliance costs for large companies | $144,948,764 | $355,816*1,101*37% |
| | | |
| **Total yearly ongoing compliance costs for small and large issuers** | **$172,840,320** | $27,891,556+$144,948,764 |

As discussed above in Section III.B., host country laws that prohibit the type of disclosure required under the final rules could lead to significant additional economic costs that are not captured by the compliance cost estimates above. We have attempted to assess the magnitude of these costs to the extent possible. We base our analysis on the four countries that, according to commentators, currently have some versions of such laws (although we do not know if such countries would, in fact, prohibit the required disclosure or whether there might be other countries).[626] We searched (through a text search in the EDGAR system) the Forms 10-K and 20-F of affected issuers for years 2009 and 2010 for any mention of Angola, Cameroon, China, or Qatar. An examination of many of the filings that mentioned one or more of these countries indicate that most filings did not provide detailed information on the extent of their operations in these countries.[627] Thus, we are unable to determine the total amount of capital that may be lost in these countries if the information required to be disclosed under the final rules is, in fact, prohibited by laws or regulations.

We can, however, assess if the costs of withdrawing from these four countries are in line with one commentator's estimate of tens of billions of dollars. We estimate the potential loss from terminating activities in a country with such laws by the present value of the cash flows that a firm would forgo. We assume that a firm would not suffer any substantial losses when redeploying or disposing of its assets in the host country under consideration. We then discuss how the presence of various opportunities for the use of those assets by the firm itself or another firm would affect the size of the firm's potential losses. We also discuss how

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626 See letters from API 1 and ExxonMobil 1 (mentioning Angola, Cameroon, China, and Qatar); see also letter from RDS 1 (mentioning Cameroon, China, and Qatar). Other commentators disputed the assertion that there are foreign laws that specifically prohibit disclosure of payment information. See, e.g., letters from ERI 3, Global Witness 1, PWYP 1, Publish What You Pay (December 20, 2011) ("PWYP 3"), and Rep. Frank et al.

627 We note that some issuers do not operate in those four countries, and thus, would not have any such information to disclose. Other issuers may have determined that they were not required to provide detailed information in their filings regarding their operations in those countries.

these losses would be affected if a firm cannot redeploy the assets in question easily, or it has to sell them with a steep discount (a fire sale). In order to estimate the lost cash flows, we assume that the cash flows from the projects in one of these countries are a fraction of the firm's total cash flows, and this fraction is equal to the ratio of total project assets in the given country to the firm's total assets. Also, we assume that the estimated cash flows grow annually at the rate of inflation over the life of the project.

We were able to identify a total of 51 issuers that mentioned that they have operations in these countries (some operate in more than one country). The table below provides information from 19 of the 51 issuers with regard to projects disclosed in their Forms 10-K and 20-F.[628]

628 As we noted, we identified 51 issuers that disclosed operations in at least one of the four countries, but only 19 of the issuers provided information with regard to projects in those countries that was specific enough to use in our analysis.

| Issuer | Project assets ($ mil) | Project term (yrs) | Investments ($ mil) | Revenues ($ mil) | Expenses ($ mil) | Country |
|---|---|---|---|---|---|---|
| Issuer 1 | 7,320 | 25 | | | | Angola |
| Issuer 2 | | 20 | 18.8 | | | Angola |
| Issuer 3 | | 21 | 1853 | | | Angola |
| Issuer 4 | 724 | 4 | | 322.3 | | Angola |
| Issuer 5 | 51.1 | | | 22 | | Cameroon |
| Issuer 6 | | 16 | | | | Cameroon |
| Issuer 7 | | | 11.4 | | | Angola |
| Issuer 8 | | | | 66.2 | 14 | Angola |
| Issuer 9 | 91.7 | | | 78.8 | | Qatar |
| Issuer 10 | 364.7 | | | 158.1 | | Qatar |
| Issuer 11 | 2.8 | | | 2.7 | | Qatar |
| Issuer 12 | 86.1 | | | 27.1 | | Angola |
| Issuer 13 | 722 | 25 | | | | Qatar |
| Issuer 14 | | | 0.33 | | | China |
| Issuer 15 | | 23 | | | | China |
| Issuer 16 | 155 | | 59 | 45 | | China |
| Issuer 17 | 261.5 | | | | | China |
| Issuer 18 | | | | 2.1 | 11.7 | China |
| Issuer 19 | 605.2 | | | 177.6 | | China |

From the issuers with information on projects in Angola, Cameroon, China, or Qatar, we select Issuer 1's and Issuer 4's Angola projects and Issuer 13's Qatar project because they reported data on both the firm assets involved in the projects in these countries and the terms of these projects. Other issuers reported some relevant information, but not enough, in our opinion, to meaningfully evaluate the cash flows of their projects. We supplemented the Angola data for the two issuers with firm financial information for the 2008 and 2009 fiscal years from Compustat. In addition, we obtained Issuer 1's and Issuer 13's weighted-average cost of capital (WACC) from Bloomberg, although data was not available on Issuer 4's

WACC.[629] Instead, we assumed for these purposes it has a similar WACC as another issuer of a similar size for which WACC was available from Bloomberg. We assume that the purchasing power parity holds and thus use the U.S. inflation rate for 2009 as a constant growth rate for the projects' cash flows.[630]

In the table below we estimate the cash flows of Issuer 1's and Issuer 4's Angola projects and Issuer 13's Qatar project using a standard valuation methodology – the present value of discounted cash flows – and assuming a corporate tax rate of 30% for all three issuers. For Issuer 1, we estimate that a termination of its projects in Angola would result in lost cash flows of approximately $12 billion. For Issuer 4, the loss would be approximately $119 million. For Issuer 13, the loss would be approximately $392 million.

629 In 2011, Issuer 4 was acquired by another issuer.

630 Data on the U.S. inflation rate is obtained from the Bureau of Labor Statistics.

| Financial information FY2009 ($ mil) | Issuer 1 | Issuer 4 | Issuer 13 | Calculation |
|---|---|---|---|---|
| Earnings before interest and taxes (EBIT) | 26,239 | 469 | 3,689 | |
| Depreciation/Amortization | 11,917 | 159 | 830 | |
| Change in deferred taxes | -1,472 | -59 | 0 | |
| Capital expenditures | 17,770 | 301 | 1,914 | NetPP&E2009 - Net PP&E2008 |
| Change in working capital | -19,992 | -188 | 277 | Working capital = Current assets - Current liabilities |
| Tax rate (%) | 30% | 30% | 30% | |
| Company free cash flow (FCF) | 31,034 | 314 | 1,221 | EBIT*(1-tax rate) + Depreciation/Amort-ization +Change in Deferred taxes - Capital Expenditures - Change in Working Capital |
| Firm total assets | 233,323 | 6,143 | 19,393 | |
| Angola/Qatar total assets | 7,320 | 724 | 722 | |
| Angola/Qatar FCF | 974 | 37 | 45 | Company FCF*(Angola or Qatar TA / Firm TA) |
| Term of Angola/Qatar project (years) | 25 | 4 | 25 | |
| Company cost of capital (WACC) | 0.09 | 0.1098 | 0.1329 | |
| U.S. 2009 inflation rate (i) | 0.027 | 0.027 | 0.027 | |
| Present value of Angola/Qatar FCFs | 11,966 | 119 | 392 | Angola or Qatar FCF * [1/(WACC-i) – (1+i) ^term of project /(WACC-i)*(WACC+1)^term of project] |

Even though our analysis was limited to just three issuers, these estimates suggest commentators' concerns that the impact of such host country laws could add billions of dollars of costs to affected issuers, and hence have a significant impact on their profitability and competitive position, appear warranted. The assumption underlying these estimates is that each firm either sells its assets in that particular country at their accounting value or holds on to them but does not use them in other projects. The losses could be larger than the estimates in the table above if these firms are forced to sell their assets in the above-mentioned host countries at fire sale prices. In that case, the price discount will add to the loss of cash flows. While we do not have data on fire sale prices for the industries of the affected issuers, financial studies on other industries could provide some estimates. For example, a study on the airline industry[631] finds that planes sold by financially distressed airlines bring 10 to 20 percent lower prices than those sold by undistressed airlines. If we apply those percentages to the accounting value of the three issuers' assets in these host countries, this would add hundreds of millions of dollars to their potential losses. These costs also could be significantly higher than our estimates if we allow the cash flows of the project to grow annually at a rate higher than the rate of inflation.

Alternatively, a firm could redeploy these assets to other projects that would generate cash flows. If a firm could redeploy these assets relatively quickly and without a significant cost to projects that generate similar rates of returns as those in the above-mentioned countries, then the firm's loss from the presence of such host country laws would be

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631 See Todd Pulvino 1998. "Do Fire-Sales Exist? An Empirical Study of Commercial Aircraft Transactions." Journal of Finance, 53(3): 939–78.

minimal. The more difficult and costly it is for a firm to do so, and the more difficult it is to find other projects with similar rates of return, the larger the losses of the firm would be. Unfortunately, we do not have enough data to quantify more precisely the potential losses of firms under those various circumstances. Likewise, if the firm could sell those assets to a buyer (e.g., a non-reporting issuer) that would use them for similar projects in the host country or elsewhere, then the buyer would likely pay the fair market value for those assets, resulting in minimal to no loss for the firm.

Overall, the results of our analysis concur with commentators that the presence of host country laws that prohibit the type of disclosure required under the final rules could be very costly. The size of the potential loss to issuers will depend on the presence of other similar opportunities, third parties willing to buy the assets at fair-market values in the above-mentioned host countries, and the ability of issuers to avoid fire sale of these assets.

As noted above, we considered alternatives to the approach we are adopting in the final rules, including providing certain exemptions from the disclosure requirements mandated by Section 13(q), but we believe that adopting any of the alternatives would be inconsistent with Section 13(q) and would undermine Congress' intent to promote international transparency efforts. To faithfully effectuate Congressional intent, we do not believe it would be appropriate to adopt provisions that would frustrate, or otherwise be inconsistent with, such intent. Consequently, we believe the competitive burdens arising from the need to make the required disclosures under the final rules are necessary by the terms of, and in furtherance of the purposes of, Section 13(q).

A number of factors may serve to mitigate the competitive burdens arising from the required disclosure. We note there were differences in opinion among commentators as to the applicability of host country laws.[632] Moreover, the widening global influence of the EITI and the recent trend of other jurisdictions to promote transparency, including listing requirements adopted by the Hong Kong Stock Exchange and proposed directives of the European Commission, may discourage governments in resource-rich countries from adopting new prohibitions on payment disclosure.[633] Reporting companies concerned that disclosure required by Section 13(q) may be prohibited in a given host country may also be able to seek authorization from the host country in order to disclose such information, reducing the cost to such reporting companies resulting from the failure of Section 13(q) to include an exemption for conflicts with host country laws.[634]

## IV. PAPERWORK REDUCTION ACT

### A. Background

Certain provisions of the final rules contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[635] We published a notice requesting comment on the collection of information requirements in the Proposing Release for the rule amendments. An agency may not conduct or sponsor, and a person is

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632 See note 84 and accompanying text.

633 See notes 15 and 48 and accompanying text.

634 See note 584.

635 44 U.S.C. 3501 et seq.

not required to comply with, a collection of information unless it displays a currently valid control number. The title for the collection of information is:

- "Form SD" (a new collection of information).[636]

We are amending Form SD to contain disclosures required by Rule 13q-1, which will require resource extraction issuers to disclose information about payments made by the issuer, a subsidiary of the issuer, or an entity under the control of the issuer to foreign governments or the U.S. Federal Government for the purpose of the commercial development of oil, natural gas, or minerals. Form SD will be filed on EDGAR with the Commission.[637]

The new rules and amendment to the form implement Section 13(q) of the Exchange Act, which was added by Section 1504 of the Act. Section 13(q) requires the Commission to "issue final rules that require each resource extraction issuer to include in an annual report of the resource extraction issuer information relating to any payment made by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals, including – (i) the type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals, and (ii) the

636 As previously noted, in another release we are issuing today, we are adopting rules to implement the requirements of Section 1502 of the Dodd-Frank Act and requiring issuers subject to those requirements to file the disclosure on Form SD. See note 30 and accompanying text (referencing the Conflict Minerals Adopting Release, Release 34-67716 (August 22, 2012).

637 The information required by Rule 13q-1 and Form SD is similar to the information that would have been required under the proposal in Forms 10-K, 20-F, or 40-F and Item 105 of Regulation S-K. We do not believe that requiring the information to be filed in a Form SD, rather than furnishing it in an issuer's Exchange Act annual reports, will affect the burden estimate.

type and total amount of such payments made to each government."[638] Section 13(q) also mandates the submission of the payment information in an interactive data format, and provides the Commission with the discretion to determine the applicable interactive data standard.[639] We are adopting the requirement regarding the presentation of the mandated payment information substantially as proposed, except that a resource extraction issuer will be required to present the mandated payment information in only one exhibit to new Form SD instead of two exhibits, as proposed. We have decided to require only one exhibit formatted in XBRL because we believe that we can achieve the goal of the dual presentation with only one exhibit. The disclosure requirements apply equally to U.S. issuers and foreign issuers meeting the definition of a resource extraction issuer. As discussed in detail above, in adopting the final rules, we have made significant changes to the rules that were proposed.

Compliance with the rules by affected issuers is mandatory. Responses to the information collections will not be kept confidential and there is no mandatory retention period for the collection of information.

### B. Summary of the Comment Letters

As proposed, the required disclosure would have been included in a resource extraction issuer's Form 10-K, Form 20-F, or Form 40-F, as appropriate. We estimated in the Proposing Release the number of issuers filing each of the forms that would likely be

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638 15 U.S.C. 78m(q)(2)(A).

639 15 U.S.C. 78m(q)(2)(C) and (D).

resource extraction issuers totaled 1,101 issuers.[640] We estimated the total annual increase in the paperwork burden for all affected companies to comply with our proposed collection of information requirements to be approximately 52,932 hours of company personnel time and approximately $11,857,200 for the services of outside professionals. We also estimated in the Proposing Release that the annual incremental paperwork burden for each of Form 10-K, Form 20-F, and Form 40-F would be 75 burden hours per affected form.[641]

In the Proposing Release we requested comment on the PRA analysis. We received ten comment letters that addressed PRA-related costs specifically;[642] we also received a number of comment letters that discussed the costs and burdens to issuers generally that we considered in connection with our PRA analysis.[643] Section III.B.2 contains a detailed summary of these comments. As described above, some commentators disagreed with our industry-wide estimate of the total annual increase in the paperwork burden and argued that it underestimated the actual costs that would be associated with the rules.[644] Some

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640 For purposes of the PRA, we estimated that the number of resource extraction issuers that would annually file Form 10-K would be approximately 861, the number of such issuers that would annually file Form 20-F would be approximately 166, and the number of such issuers that would annually file Form 40-F would be approximately 74. We derived these estimates by determining the number of issuers that fall under SIC codes that pertain to oil, natural gas, and mining companies and, thus, are most likely to be resource extraction issuers. The estimate for Form 10-K was derived by subtracting from the total number of resource extraction issuers the number of issuers that file annual reports on Form 20-F and Form 40-F.

641 In estimating 75 burden hours, we looked to the burden hours associated with the disclosure required by the oil and gas rules adopted in 2008, which estimated an increase of 100 hours for domestic issuers and 150 hours for foreign private issuers.

642 See letters from API 1, API 2, Barrick Gold, ERI 2, ExxonMobil 1, ExxonMobil 3, NMA 2, Rio Tinto, RDS 1, and RDS 4.

643 See letters from BP 1, Chamber Energy Institute, Chevron, Cleary, Hermes, and PWYP 1.

644 See letters from API 1 and ExxonMobil 1.

commentators also stated that, depending upon the final rules adopted, the compliance burdens and costs caused by implementation and ongoing compliance with the rules would be significantly greater than those estimated by the Commission.[645]

We note that commentators did not object, or suggest alternatives, to our estimate of the number of issuers who would be subject to the proposed rules. As discussed below, we have made several changes to our estimates in response to comments on the estimates contained in the Proposing Release that are designed to better reflect the burdens associated with the new collection of information.

### C. Revisions to PRA Reporting and Cost Burden Estimates

After considering the comments, and the changes we are making from the proposal, we have revised our PRA estimates for the final rules. As discussed above, we are adopting new Rule 13q-1 and an amendment to new Form SD to require resource extraction issuers to disclose the required payment information in a new form rather than including the disclosure requirements in existing Exchange Act annual reports. As described above, Rule 13q-1 requires resource extraction issuers to file the payment information required in Form SD. The collection of information requirements are reflected in the burden hours estimated for Form SD. Therefore, Rule 13q-1 does not impose any separate burden.

For purposes of the PRA, we continue to estimate that 1,101 issuers will be subject to Rule 13q-1. We have derived our burden estimates by estimating the average number of hours it would take an issuer to prepare and file the required disclosure. In deriving our

645 See letters from API 1, Barrick Gold, ExxonMobil 1, NMA 2, Rio Tinto, and RDS 1.

estimates, we recognize that that the burdens will likely vary among individual issuers based on a number of factors, including the size and complexity of their operations. We believe that some issuers will experience costs in excess of this average in the first year of compliance with the rules, and some issuers may experience less than these average costs. When determining these estimates, we have assumed that 75% of the burden of preparation is carried by the issuer internally and 25% of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of $400 per hour.[646] The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours. As discussed above, we received estimates from some commentators expressed in burden hours and estimates from other commentators expressed in dollar costs. For purposes of this analysis and consistent with our approach with respect to the estimates provided in burden hours, we assume 25% of the dollar costs provided by commentators relate to costs for outside professionals.[647] We expect that the rules' effect will be greatest during the first year of their effectiveness and diminish in subsequent years. To account for this expected diminishing burden, we believe a three-year average of the expected burden during the first year with the expected ongoing burden

646 We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis we estimate that such costs would be an average of $400 per hour. This is the rate we typically estimate for outside legal services used in connection with public company reporting. We note that no commentators provided us with an alternative rate estimate for these purposes.

647 The comment letters providing dollar estimates did not explain how they arrived at such estimates, or provide any calculations as to the cost per hour. As such, we have included 25% of the dollar cost estimate in our calculation of costs of outside professionals, but we were not provided with sufficient data to convert commentators' dollar cost estimates into burden hour estimates.

during the next two years is a reasonable estimate. After considering the comments we received, we are revising our estimate of the PRA compliance burden hours and costs associated with the disclosure requirements.[648]

In arriving at our initial estimate in the Proposing Release we looked to the burden hours associated with the disclosure required by the oil and gas rules adopted in 2008, and estimated that the burden would be less based on our belief that the disclosure required by the proposed rules was less extensive that the oil and gas rules adopted in 2008. As discussed above, some commentators believed that our initial estimates did not adequately reflect the actual burden associated with complying with the proposed disclosure requirements.[649] Based on the comments we received, we have increased our estimate of the total annual compliance burden for all affected issuers to comply with the collection of information in our final rules to be approximately 332,123 hours of company personnel time and approximately $144,967,250 for the services of outside professionals, as discussed in detail below.

Some commentators estimated implementation costs of tens of millions of dollars for large filers, and millions of dollars for smaller filers.[650] These commentators did not describe how they defined "small" and "large" filers. One commentator provided an estimate of $50

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648 Although the comments we received with respect to our PRA estimates related to the proposal to include the disclosure requirements in Forms 10-K, 20-F, and 40-F, we have considered these estimates in arriving at our estimate for Form SD because, although the disclosures will be provided pursuant to a new rule and in a new form, the disclosure requirements themselves are generally not impacted by moving the disclosure to a different form. In the Proposing Release we requested comment on whether the required disclosure should be provided in a new form. We believe that any additional burden created by the use of a new form, rather than existing annual reports, will be minimal. See also letters from API 1 and Cleary.

649 See notes 526 and 527 and accompanying text.

650 See letters from API 1 and ExxonMobil 1.

million in implementation costs if the definition of "project" is narrow and the level of disaggregation is high across other reporting parameters, though it did not provide alternate estimates for different definitions of "project," leaving project undefined, or different levels of disaggregation.[651] We note that the commentator that provided this estimate is among the largest 20 oil and gas companies in world,[652] and we believe that the estimate it provided may be representative of the costs to companies of similar large size, though it is likely not a representative estimate of the burden for resource extraction issuers that are smaller than this commentator. While we received estimates for smaller filers and an estimate for one of the largest filers, we did not receive data on companies of varying sizes in between the two extremes.

Similar to our economic analysis above, to account for the range of issuers who will be subject to the final rules, for purposes of this analysis, we have used the cost estimates provided by these issuers to calculate different cost estimates for issuers of different sizes based on either assets or market capitalization. We have estimated costs for small issuers (issuers with less than $75 million in market capitalization) and larger issuers (issuers with $75 million or more in market capitalization). We believe that initial implementation costs will be lowest for the smallest issuers and incrementally greater for larger issuers. Based on a review of market capitalization data of Exchange Act registrants filing under certain

651 See letter from ExxonMobil 1. Although the rules we are adopting differ from the assumptions made by the commentator, we do not believe we have a basis for deriving a different estimate.

652 See letter from API (October 12, 2010) (pre-proposal letter)(ranking the 75 largest oil and gas companies by reserves and production).

Standard Industry Classification codes, we estimate that there are approximately 699 small issuers and 402 large issuers.

We use Method 2 from our Economic Analysis above[653] for our estimate of total compliance burden. Barrick Gold's estimate[654] of 1000 hours for compliance (500 hours for initial changes to internal books and records and 500 hours for initial compliance) is the starting point of the analysis.[655] Barrick Gold is a large accelerated filer, so we use 1000 hours as the burden estimate for large issuers. In order to determine the number of hours for a small issuer, we scale Barrick Gold's estimate of the number of hours by the relative size of a small issuer. In the Economic Analysis above, the ratio of all small issuer total assets, $353 billion ($509,000,000 x 63% x 1,101), to all large issuer total assets, $1,835 billion ($4,504,000,000 x 37% x 1,101), is 19%. In order to be conservative, rather than using 19%, we estimate that the number of burden hours for small issuers will be 25% of the burden hours of large issuers, resulting in 250 hours.

We received comments and estimates on the PRA analysis both in hours necessary to comply with the rules and dollar costs of compliance, as discussed above. In the Economic

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653 Method 2 estimates compliance costs separately for small and large issuers. See Section III.D. above. Because 63% of the issuers estimated to be subject to the final rules are small issuers, we believe that, for PRA purposes, Method 2 provides for a more accurate assessment of Form SD's compliance costs than Method 1, which is based on deriving an average of costs.

654 We use Barrick Gold's estimate because it is the only commentator that provided a number of hours and dollar value estimates for initial and ongoing compliance costs. Although in the Economic Analysis section we used ExxonMobil's dollar value estimate to calculate an upper bound of compliance costs, we are unable to calculate the number of burden hours for purposes of the PRA analysis using ExxonMobil's inputs.

655 As noted above, the costs for PRA purposes are only a portion of the costs associated with complying with the final rules.

Analysis above, we assume that the commentators' estimates represent total implementation costs, including both internal costs and outside professional costs. For purposes of this PRA analysis, we assume, as we have throughout the analysis, that 25% of this burden of preparation represents the cost of outside professionals.

We believe that the burden associated with this collection of information will be greatest during the implementation period to account for initial set up costs, but that ongoing compliance costs will be less than during the initial implementation period once companies have made any necessary modifications to their systems to capture and report the information required by the rules. Two commentators provided estimates of ongoing compliance costs: Rio Tinto provided an estimate of 5,000 – 10,000 burden hours for ongoing compliance,[656] while Barrick Gold provided an estimate of 500 burden hours for ongoing compliance. Based on market capitalization data, Rio Tinto is among the top five percent of resource extraction issuers that are Exchange Act reporting companies. We believe that, because of the size of this commentator, the estimate it provided may be representative of the burden for resource extraction issuers of a similar size, but may not be a representative estimate for resource extraction issuers that are smaller than this commentator. We believe that Barrick Gold is more similar to the average large issuer than Rio Tinto, and as such, we believe that Barrick Gold's estimate is a conservative estimate of the ongoing compliance burden hours because a comparison of the average total assets of a large issuer to Barrick Gold's total

[656] See letter from Rio Tinto. This commentator estimated 100-200 hours of work at the head office, an additional 100-200 hours of work providing support to its business units, and a total of 4,800 – 9,600 hours by its business units. We arrived at the estimated range of 5,000 – 10,000 hours by adding the estimates provided by this commentator (100+100+4,800=5,000, and 200+200+9,600=10,000).

assets is 18% ($4,504,000,000/$25,075,000,000).[657] As discussed above, commentators' estimates on the burdens associated with initial implementation and ongoing compliance varied widely, with commentators noting that the estimates varied based on the size of issuer.[658] We note that some estimates may reflect the burden to a particular commentator, and, as such, may not be a representative estimate of the burden for resource extraction issuers that are smaller or larger than the particular commentator.[659] Accordingly, we have revised our estimate using an average of the figures provided to produce a reasonable estimate of the potential burden associated with the rules, recognizing they would apply to resource extraction issuers of different sizes. We are using 500 burden hours (Barrick Gold's estimate) for our estimate of ongoing compliance costs for large issuers and 125 (25% x 500) for small issuers. Thus, we estimate that the incremental collection of information burden associated with the final rules and form amendment will be 667 burden hours per large respondent [(1000 + 500 + 500)/ 3 years] and 250 per small respondent [(500 + 125 +125)/ 3 years]. We estimate the final rules and form amendment will result in an internal burden to small resource extraction issuers of 131,063 hours (699 forms x 250 hours/form x .75) and to large resource extraction issuers of 201,101 hours (402 forms x 667 hours/form x .75) for a total incremental company burden of 332,164 hours. Outside professional costs will be

657 The average large issuer's total assets compared to Rio Tinto's total assets ($97 billion) is 4.5%. See note 625 for an explanation of the average large issuer's total assets.

658 See letter from API 1 (estimating implementation costs in the tens of millions of dollars for large filers and millions of dollars for many smaller filers). This commentator did not explain how it defined small and large filers.

659 We note, for example, one commentator's letter indicating that it had approximately 120 operating entities. See letter from Rio Tinto.

$17,475,000 (699 forms x 250 hours/form x .25 x $400) for small resource extraction issuers and $26,813,400 (402 forms x 667 hours/form x .25 x $400). As discussed above, one commentator, Barrick Gold, indicated that its initial compliance costs also would include $100,000 for IT consulting, training, and travel costs. To account for these costs, we have used Barrick Gold's estimate and applied the same 25% factor to derive estimated IT costs of $100,000 for large issuers and $25,000 for small issuers. Thus, we estimate total IT compliance costs for small issuers to be $17,475,000 (699 issuers x $25,000) and for large issuers to be $40,200,000 (402 issuers x $100,000). We have added the estimated IT compliance costs to the cost estimates for other professional costs discussed above to derive total professional costs of $34,950,000 for small issuers and $67,013,400 for large issuers. The estimated overall professional cost for PRA purposes is $101,963,400.

### D. Revised PRA Estimate

The table below illustrates the annual compliance burden of the Form SD collection of information.

| Issuer Size | Annual Responses (A) | Incremental Burden Hours / Form (B) | Increase in Burden Hours (C)= (A*B)*0.75 | Increase in Professional Costs (D) | Increase in IT Costs/issuer (E) | Total Increase Professional and IT Costs (F) = (D)+(E) |
|---|---|---|---|---|---|---|
| Small | 699 | 250 | 131,063 | $17,475,000 | $17,475,000 | $34,950,000 |
| Large | 402 | 667 | 201,101 | $26,813,400 | $40,200,000 | $67,013,400 |
| **Total** | 1101 | | **332,164** | | | **$101,963,400** |
| | | | | | | |

Our PRA estimate is within the range of our estimates in the Economic Analysis section above.[660]

## V. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

This Final Regulatory Flexibility Act Analysis ("FRFA") has been prepared in accordance with the Regulatory Flexibility Act.[661] This FRFA relates to the final rules we are adopting to implement Section 13(q) of the Exchange Act, which concerns certain disclosure obligations of resource extraction issuers. As defined by Section 13(q), a resource

660 Despite using Barrick Gold's estimate, our revised estimate of PRA professional costs of $101,963,400 is higher than the lower bound of compliance costs ($43,757,043) estimated under Method 2 in the Economic Analysis section, which is also based on Barrick Gold's estimate. This is mainly because we estimate the PRA costs as fixed costs for smaller and larger issuers, whereas in the Economic Analysis section, because of the nature of the data provided by commentators, we estimate the total compliance costs as variable costs.

661 5 U.S.C. 601.

extraction issuer is an issuer that is required to file an annual report with the Commission, and engages in the commercial development of oil, natural gas, or minerals.

## A. Reasons for, and Objectives of, the Final Rules

The final rules are designed to implement the requirements of Section 13(q) of the Exchange Act, which was added by Section 1504 of the Dodd-Frank Act. Specifically, the new rule and form amendment will require a resource extraction issuer to disclose in an annual report certain information relating to payments made by the issuer, a subsidiary of the issuer, or an entity under the control of the issuer to a foreign government or the United States Federal Government for the purpose of the commercial development of oil, natural gas, or minerals. A resource extraction issuer will have to disclose the required payment information annually in new Form SD and include an exhibit with the required payment information formatted in XBRL.

## B. Significant Issues Raised by Public Comments

In the Proposing Release, we requested comment on any aspect of the Initial Regulatory Flexibility Act Analysis ("IRFA"), including the number of small entities that would be affected by the proposed rules, the nature of the impact, how to quantify the number of small entities that would be affected, and how to quantify the impact of the proposed rules. We did not receive comments specifically addressing the IRFA; however, several commentators addressed aspects of the proposed rules that could potentially affect small entities. Some commentators supported an exemption for a "small entity" or "small business" having \$5 million or less in assets on the last day of its most recently completed fiscal year.[662] Other commentators opposed an exemption for small entities and other smaller companies. Those commentators noted that, while smaller companies have more limited operations and projects, and therefore fewer payments to disclose as compared to larger companies, they generally take on greater risks due to the nature of their operations.[663]

### C. Small Entities Subject to the Final Rules

The final rules will affect small entities that are required to file an annual report with the Commission under Section 13(a) or Section 15(d) of the Exchange Act, and are engaged in the commercial development of oil, natural gas, or minerals. Exchange Act Rule 0-10(a)[664] defines an issuer to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year. We believe that the final rules will affect some small entities that meet the definition of resource extraction issuer under Section 13(q). Based on a review of total assets for Exchange Act registrants filing under certain Standard Industry Classification codes, we estimate that approximately 196 oil, natural gas, and mining companies are resource extraction issuers and that may be considered small entities.

### D. Reporting, Recordkeeping, and other Compliance Requirements

The final rules will add to the annual disclosure requirements of companies meeting the definition of resource extraction issuer, including small entities, by requiring them to file

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662 See letters from API 1, Chevron, ExxonMobil 1, and RDS 1.

663 See letters from Calvert, Global Witness 1, Oxfam 1, PWYP 1, Sen. Cardin et al. 1, and Soros 1.

664 17 CFR 240.0-10(a).

the payment disclosure mandated by Section 13(q) and the rules issued thereunder in new Form SD. The disclosure must include:

- the type and total amount of payments made for each project of the issuer relating to the commercial development of oil, natural gas, or minerals; and
- the type and total amount of those payments made to each government.

A resource extraction issuer must provide the required disclosure in Form SD and in an exhibit formatted in XBRL. Consistent with the statute, the rules require an issuer to submit the payment information using electronic tags that identify, for any payments made by a resource extraction issuer to a foreign government or the U.S. Federal Government:

- the total amounts of the payments, by category;
- the currency used to make the payments;
- the financial period in which the payments were made;
- the business segment of the resource extraction issuer that made the payments;
- the government that received the payments, and the country in which the government is located; and
- the project of the resource extraction issuer to which the payments relate.

In addition, a resource extraction issuer will be required to provide the type and total amount of payments made for each project and the type and total amount of payments made to each government in XBRL format. The disclosure requirements will apply equally to U.S. and foreign resource extraction issuers.

## E. Agency Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives, while minimizing any significant adverse impact on small entities. In connection with adopting the final rules, we considered, as alternatives, establishing different compliance or reporting requirements that take into account the resources available to smaller entities, exempting smaller entities from coverage of the disclosure requirements, and clarifying, consolidating, or simplifying disclosure for small entities.

The final rules are designed to implement the payment disclosure requirements of Section 13(q), which applies to resource extraction issuers regardless of size. While a few commentators supported an exemption from the disclosure requirements for small entities,[665] numerous other commentators opposed exempting small entities because that would be inconsistent with the statute and would contravene Congress' intent of creating a level playing field for all affected issuers.[666] We do not believe that exempting resource extraction issuers that are small entities, many of which are mining companies engaged in exploration activities that require payments to governments,[667] or adopting different disclosure requirements or additional delayed compliance for small entities, would be consistent with the statutory purpose of Section 13(q). For example, we do not believe that adopting rules permitting small entities to disclose payments at the country level would be consistent with

665 See note 42 and accompanying text.

666 See note 34 and accompanying text.

667 See letters from Calvert and PWYP 1.

the statutory purpose of Section 13(q). The statute is designed to enhance the transparency of payments by resource extraction issuers to governments. Adoption of different disclosure requirements for small entities would impede the transparency and comparability of the disclosure mandated by Section 13(q). In addition, it is not clear that adopting different standards or a delayed compliance date would provide small entities with a significant benefit. For example, small entities may have a limited number of projects in a limited number of countries and in some cases small entities may have only one project in a country.

We also have considered the alternative of using performance standards rather than design standards. We generally have used design rather than performance standards in connection with the final rules because we believe the statutory language, which requires the electronic tagging of specific items, contemplates the adoption of specific disclosure requirements. We further believe the final rules will be more useful to users of the information if there are specific disclosure requirements. Such requirements will help to promote transparent and comparable disclosure among all resource extraction issuers, which should help further the statutory goal of promoting international transparency of payments to governments. At the same time, we have determined to leave the term "project" undefined to give issuers flexibility in applying the term to different business contexts depending on factors such as the particular industry or business in which the issuer operates, or the issuer's size.

## VI. STATUTORY AUTHORITY AND TEXT OF FINAL RULE AND FORM AMENDMENTS

We are adopting the rule and form amendments contained in this document under the authority set forth in Sections 3(b), 12, 13, 15, 23(a), and 36 the Exchange Act.

**List of Subjects**

17 CFR Parts 240 and 249b

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, we are amending Title 17, Chapter II of the Code of Federal Regulations as follows:

**PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

1. The authority citation for part 240 is amended by adding an authority for § 240.13q-1 in numerical order to read as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78dd(b), 78dd(c), 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq. and 8302; 18 U.S.C. 1350; 12 U.S.C. 5221(e)(3); and Pub. L. 111-203, Sec. 712, 124 Stat. 1376, (2010) unless otherwise noted.

* * * * *

Section 240.13q-1 is also issued under sec. 1504, Pub. L. No. 111-203, 124 Stat. 2220.

* * * * *

2. Add § 240.13q-1 to read as follows:

**§ 240.13q-1 Disclosure of payments made by resource extraction issuers.**

(a) A resource extraction issuer, as defined by paragraph (b) of this section, shall file a report on Form SD (17 CFR 249b.400) within the period specified in that Form disclosing the information required by the applicable items of Form SD as specified in that Form.

(b) Definitions. For the purpose of this section:

(1) Resource extraction issuer means an issuer that:

(i) Is required to file an annual report with the Commission; and

(ii) Engages in the commercial development of oil, natural gas, or minerals.

(2) Commercial development of oil, natural gas, or minerals includes exploration, extraction, processing, and export of oil, natural gas, or minerals, or the acquisition of a license for any such activity.

**PART 249b – FURTHER FORMS, SECURITIES EXCHANGE ACT OF 1934**

3. The authority citation for part 249b is amended by adding an authority for § 249b.400 to read as follows:

Authority: 15 U.S.C. 78a et seq., unless otherwise noted.

* * * * *

Section 249b.400 is also issued under secs. 1502 and 1504, Pub. L. No. 111-203, 124 Stat. 2213 and 2220.

* * * * *

4. Revise § 249b.400 by:

a. Revising the paragraph in § 249b.400 to insert "(a)" before the paragraph; and

b. adding paragraph (b) to § 249b.400.

The amendment should read as follows:

**§ 249b.400 Form SD, Specialized Disclosure Report**

(a) * * *

(b) This Form shall be filed pursuant to Rule 13q-1 (§ 240.13q-1) of this chapter by resource extraction issuers that are required to disclose the information required by Section 13(q) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(q)) and Rule 13q-1 of this chapter.

5. Revise Form SD (as referenced in § 249b.400) by:

a. Adding a check box for Rule 13q-1;

c. Revising instruction A. under "General Instructions";

d. Revising the "General Instructions" to redesignate instructions B.2. and as B.3 and adding new instruction B.2. and B.4.; and

e. Revising the "Information to be Included in the Report" by redesignating Section 2 as Section 3, adding new Section 2, and revising Section 3.

The amendment should read as follows:

**Note: The text of Form SD does not, and this amendment will not, appear in the Code of Federal Regulations.**

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

## FORM SD

### SPECIALIZED DISCLOSURE REPORT

______________________________________________________________________

(Exact name of the registrant as specified in its charter)

______________________________________________________________________

(State or other jurisdiction of incorporation) (Commission file number)

______________________________________________________________________

(Address of principle executive offices) (Zip code)

______________________________________________________________________

(Name and telephone number, including area code, of the person to contact in connection with this report.)

Check the appropriate box to indicate the rule pursuant to which this form is being filed:

___ Rule 13p-1 under the Securities Exchange Act (17 CFR 240.13p-1) for the reporting period from January 1 to December 31, __________.

___ Rule 13q-1 under the Securities Exchange Act (17 CFR 240.13q-1) for the fiscal year ended _______.

## GENERAL INSTRUCTIONS

**A. Rule as to Use of Form SD.**

This form shall be used for a report pursuant to Rule 13p-1 (17 CFR 240.13p-1) and Rule 13q-1 (17 CFR 240.13q-1) under the Exchange Act.

**B. Information to be Reported and Time for Filing of Reports.**

1. * * *

2. Form filed under Rule 13q-1. File the information required by Section 2 of this Form on EDGAR no later than 150 days after the end of the issuer's most recent fiscal year.

3. If the deadline for filing this form occurs on a Saturday, Sunday or holiday on which the Commission is not open for business, then the deadline shall be the next business day.

4. The information and documents filed in this report shall not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, unless the registrant specifically incorporates it by reference into a filing under the Securities Act or the Exchange Act.

* * * * *

## INFORMATION TO BE INCLUDED IN THE REPORT

* * * * *

**Section 2 – Resource Extraction Issuer Disclosure**

**Item 2.01 Disclosure requirements regarding payments to governments**

(a) A resource extraction issuer shall file an annual report on Form SD with the Commission, and include as an exhibit to this Form SD, information relating to any payment made during the fiscal year covered by the annual report by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer, to a foreign government or the United States Federal Government, for the purpose of the commercial development of oil, natural gas, or minerals. Specifically, a resource extraction issuer must file the following information in an exhibit to this Form SD electronically formatted using the eXtensible Business Reporting Language (XBRL) interactive data standard:

(1) The type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals;

(2) The type and total amount of such payments made to each government;

(3) The total amounts of the payments, by category listed in (c)(6)(iii);

(4) The currency used to make the payments;

(5) The financial period in which the payments were made;

(6) The business segment of the resource extraction issuer that made the payments;

(7) The government that received the payments, and the country in which the government is located; and

(8) The project of the resource extraction issuer to which the payments relate.

(b) Provide a statement in the body of the Form SD that the specified payment disclosure required by this form is included in an exhibit to this form.

(c) For purposes of this item:

(1) The term commercial development of oil, natural gas, or minerals includes exploration, extraction, processing, and export of oil, natural gas, or minerals, or the acquisition of a license for any such activity.

(2) The term foreign government means a foreign government, a department, agency, or instrumentality of a foreign government, or a company owned by a foreign government. As used in Item 2.01, foreign government includes a foreign national government as well as a foreign subnational government, such as the government of a state, province, county, district, municipality, or territory under a foreign national government.

(3) The term financial period means the fiscal year in which the payment was made.

(4) The term business segment means a business segment consistent with the reportable segments used by the resource extraction issuer for purposes of financial reporting.

(5) The terms "subsidiary" and "control" are defined as provided under § 240.12b-2 of this chapter.

(6) The term payment means an amount paid that:

(i) Is made to further the commercial development of oil, natural gas, or minerals;

(ii) Is not de minimis; and

(iii) Includes:

(A) Taxes;

(B) Royalties;

(C) Fees;

(D) Production entitlements;

(E) Bonuses;

(F) Dividends; and

(G) Payments for infrastructure improvements.

(7) The term not de minimis means any payment, whether made as a single payment or a series of related payments, that equals or exceeds $100,000. In the case of any arrangement providing for periodic payments or installments, a resource extraction issuer must consider the aggregate amount of the related periodic payments or installments of the related payments in determining whether the payment threshold has been met for that series of payments, and accordingly, whether disclosure is required.

**Instructions**

1. If a resource extraction issuer makes an in-kind payment of the types of payments required to be disclosed, the issuer must disclose the payment. When reporting an in-kind payment, an issuer must determine the monetary value of the in-kind payment and tag the information as "in-kind" for purposes of the currency. For purposes of the disclosure, an issuer may report the payment at cost, or if cost is

not determinable, fair market value and should provide a brief description of how the monetary value was calculated.

2. If a government levies a payment, such as a tax or dividend, at the entity level rather than on a particular project, a resource extraction issuer may disclose that payment at the entity level. To the extent that payments, such as corporate income taxes and dividends, are made for obligations levied at the entity level, an issuer may omit certain tags that may be inapplicable (e.g., project tag, business segment tag) for those payment types as long as it provides all other electronic tags, including the tag identifying the recipient government.
3. An issuer must report the amount of payments made for each payment type, and the total amount of payments made for each project and to each government, during the reporting period in either U.S. dollars or the issuer's reporting currency. If an issuer has made payments in currencies other than U.S. dollars or its reporting currency, it may choose to calculate the currency conversion between the currency in which the payment was made and U.S. dollars or the issuer's reporting currency, as applicable, in one of three ways: (a) by translating the expenses at the exchange rate existing at the time the payment is made; (b) using a weighted average of the exchange rates during the period; or (c) based on the exchange rate as of the issuer's fiscal year end. A resource extraction issuer must disclose the method used to calculate the currency conversion.
4. A company owned by a foreign government is a company that is at least majority-owned by a foreign government.

5. A resource extraction issuer must disclose payments made for taxes on corporate profits, corporate income, and production. Disclosure of payments made for taxes levied on consumption, such as value added taxes, personal income taxes, or sales taxes, is not required.

6. As used in Item 2.01(c)(6), fees include license fees, rental fees, entry fees, and other considerations for licenses or concessions. Bonuses include signature, discovery, and production bonuses.

7. A resource extraction issuer generally need not disclose dividends paid to a government as a common or ordinary shareholder of the issuer as long as the dividend is paid to the government under the same terms as other shareholders; however, the issuer will be required to disclose any dividends paid in lieu of production entitlements or royalties.

8. If an issuer meeting the definition of "resource extraction issuer" in Rule 13q-1(b)(1) is a wholly-owned subsidiary of a resource extraction issuer that has filed a Form SD disclosing the information required by Item 2.01 for the wholly-owned subsidiary, then such subsidiary shall not be required to separately file the disclosure required by Item 2.01. In such circumstances, the wholly-owned subsidiary would be required to file a notice on Form SD providing an explanatory note that the required disclosure was filed on Form SD by the parent and the date the parent filed the disclosure. The reporting parent company must note that it is filing the required disclosure for a wholly-owned subsidiary and must identify the subsidiary on Form SD. For purposes of this instruction, all of

not determinable, fair market value and should provide a brief description of how the monetary value was calculated.

2. If a government levies a payment, such as a tax or dividend, at the entity level rather than on a particular project, a resource extraction issuer may disclose that payment at the entity level. To the extent that payments, such as corporate income taxes and dividends, are made for obligations levied at the entity level, an issuer may omit certain tags that may be inapplicable (e.g., project tag, business segment tag) for those payment types as long as it provides all other electronic tags, including the tag identifying the recipient government.
3. An issuer must report the amount of payments made for each payment type, and the total amount of payments made for each project and to each government, during the reporting period in either U.S. dollars or the issuer's reporting currency. If an issuer has made payments in currencies other than U.S. dollars or its reporting currency, it may choose to calculate the currency conversion between the currency in which the payment was made and U.S. dollars or the issuer's reporting currency, as applicable, in one of three ways: (a) by translating the expenses at the exchange rate existing at the time the payment is made; (b) using a weighted average of the exchange rates during the period; or (c) based on the exchange rate as of the issuer's fiscal year end. A resource extraction issuer must disclose the method used to calculate the currency conversion.
4. A company owned by a foreign government is a company that is at least majority-owned by a foreign government.

5. A resource extraction issuer must disclose payments made for taxes on corporate profits, corporate income, and production. Disclosure of payments made for taxes levied on consumption, such as value added taxes, personal income taxes, or sales taxes, is not required.

6. As used in Item 2.01(c)(6), fees include license fees, rental fees, entry fees, and other considerations for licenses or concessions. Bonuses include signature, discovery, and production bonuses.

7. A resource extraction issuer generally need not disclose dividends paid to a government as a common or ordinary shareholder of the issuer as long as the dividend is paid to the government under the same terms as other shareholders; however, the issuer will be required to disclose any dividends paid in lieu of production entitlements or royalties.

8. If an issuer meeting the definition of "resource extraction issuer" in Rule 13q-1(b)(1) is a wholly-owned subsidiary of a resource extraction issuer that has filed a Form SD disclosing the information required by Item 2.01 for the wholly-owned subsidiary, then such subsidiary shall not be required to separately file the disclosure required by Item 2.01. In such circumstances, the wholly-owned subsidiary would be required to file a notice on Form SD providing an explanatory note that the required disclosure was filed on Form SD by the parent and the date the parent filed the disclosure. The reporting parent company must note that it is filing the required disclosure for a wholly-owned subsidiary and must identify the subsidiary on Form SD. For purposes of this instruction, all of

the subsidiary's equity securities must be owned, either directly or indirectly, by a single person that is a reporting company under the Act that meets the definition of "resource extraction issuer."

9. Disclosure is required under this paragraph in circumstances in which an activity related to the commercial development of oil, natural gas, or minerals, or a payment or series of payments made by a resource extraction issuer to a foreign government or the U.S. Federal Government for the purpose of commercial development of oil, natural gas, or minerals are not, in form or characterization, one of the categories of activities or payments specified in this section but are part of a plan or scheme to evade the disclosure required under Section 13(q).

**Section 3 – Exhibits**

**Item 3.01 Exhibits**

List below the following exhibits filed as part of this report.

Exhibit 1.01 – Conflict Minerals Report as required by Items 1.01 and 1.02 of this Form.

Exhibit 2.01 – Resource Extraction Issuer Disclosure Report as required by Item 2.01 of this Form.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the duly authorized undersigned.

______________________________
(Registrant)

By (Signature and Title)*                                        (Date)

*Print name and title of the registrant's signing executive officer under his or her signature.

* * * * *

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: August 22, 2012

Commissioner Walter,
Commissioner Gallagher
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

**INVESTMENT ADVISERS ACT OF 1940**
**Release No. 3449 / August 23, 2012**

**INVESTMENT COMPANY ACT OF 1940**
**Release No. 30181 / August 23, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14995**

**In the Matter of**

**FRANCES M. GUGGINO**
**a/k/a FRANCES FAVATA**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Frances M. Guggino a/k/a Frances Favata ("Guggino" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over her and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to and Section 203(f) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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## III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

### Summary

Frances M. Guggino, the former CFO and Treasurer of the Fixed Income Funds advised by Legg Mason Partners Fund Advisor, LLC, altered books and records of one of the mutual funds – specifically, a trial balance and Board Meeting Minutes – in order to convince others at Legg Mason & Co. ("Legg Mason") that the fund had received an advancement in connection with a Commission Fair Fund distribution, when in fact, the fund had not.[2] Among the documents she altered were investment company documents required to be created and maintained pursuant to the Investment Company Act. Thus, Guggino's alteration of these documents constitutes a violation of Section 34(a) of the Investment Company Act.

### Respondent

1. Respondent, aged 54, is a resident of Albrightsville, Pennsylvania. From 1999 until 2005, she was the Treasurer of the Citi and Salomon branded mutual funds at Citigroup, Inc. After these funds were acquired by Legg Mason in 2005, Guggino became the CFO and Treasurer of the Fixed Income Funds advised by Legg Mason Partners Fund Advisor, LLC. Guggino was employed by Legg Mason Partners Fund Advisor, LLC. She resigned in June of 2010, during the course of Legg Mason's internal investigation which ultimately revealed the document alteration. Guggino's married name is Frances Favata.

### Facts

2. On May 31, 2005, the Commission instituted settled administrative and cease-and-desist proceedings against Smith Barney Fund Management LLC ("Smith Barney") and Citigroup Global Markets, Inc. for violations of the federal securities laws. In the May 31, 2005 Order, the Commission found that Smith Barney, which served as investment adviser to the Smith Barney Family of Funds, placed its interest in making a profit ahead of the interests of the mutual funds it served in recommending a transfer agent to the Funds. See In the Matter of Smith Barney Fund Management LLC and Citigroup Global Markets, Inc., Admin. Proc. File No. 3-11935 (May 31, 2005) ("Order"). As part of the settlement of the matter, the Commission ordered the Respondents to pay disgorgement of $109,004,551, plus prejudgment interest of $19,055,630, and ordered that Smith Barney pay civil money penalties of $80,000,000. In the Order, the Commission also

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

[2] Legg Mason Partners Fund Advisor, LLC is a wholly-owned subsidiary of Legg Mason & Co.

authorized the creation of a Fair Fund to distribute the disgorgement and penalty amounts pursuant to a distribution plan developed by the Respondents.

3. On April 15, 2010, the Plan of Distribution ("Plan") in connection with this proceeding was approved by the Commission. (Rel. No. 34-61917) On May 12, 2010, the Commission issued an Order Directing Disbursement of a Fair Fund to disburse $110,782,362.95 from the Fair Fund. (Rel. No. 34-62088).

4. On December 1, 2005, Citigroup Inc. completed the sale of substantially all of its asset management business to Legg Mason. On that date, Smith Barney became a wholly owned subsidiary of Legg Mason. On August 1, 2006, Smith Barney was replaced as investment manager or investment adviser with respect to the Funds for which it served in those capacities by Legg Mason Partners Fund Advisor, LLC, a newly formed entity.[3] Legg Mason was the entity responsible for the distribution pursuant to the Plan.

5. The Plan provided for the distribution of disgorgement-related portions of the Fair Fund to mutual funds from the Smith Barney Family of Funds that engaged a Citigroup affiliate, Citicorp Trust Bank fsb or a predecessor entity (collectively, "CTB"), as their transfer agent and paid transfer agent fees to CTB between October 1, 1999, and November 30, 2004, or to successors to such Funds, in proportion to the total transfer agent fees paid to CTB by each fund or class of a Fund (subject to certain adjustments). Pursuant to the Plan, money was distributed to the asset bases of the Citi-related mutual funds through their custodian banks. These payments to the mutual funds were completed by May 26, 2010.

6. According to the Plan, in cases where the mutual funds entitled to a distribution were liquidated during the period when the Plan was still being negotiated, Legg Mason was to advance the money owed to those funds prior to their liquidation. According to representations made by Legg Mason at the time of the Plan's publication, advancements had been made by Legg Mason to nine liquidating funds ("Subsequently Liquidated Funds"). Therefore, under the Plan, a portion of the distribution was to go to Legg Mason to reimburse it for those advancements. Pursuant to the Plan, the staff requested that a third-party, namely, the custodian bank of the Subsequently Liquidated Funds, provide a confirmation that the advancements had actually been received by those funds. The staff received what purported to be that confirmation, through counsel for Legg Mason, on April 15, 2010.

7. On May 12, 2010, the Commission issued an Order to Disburse $110,782,362.95 from the Fair Fund ("Order to Disburse"). This amount included approximately $2,154,125.58 to reimburse Legg Mason for its advancements to the Subsequently Liquidated Funds. After the Commission issued the Order to Disburse, the money from the Fair Fund was transferred to the custodian bank.

8. Shortly thereafter, the Commission staff learned through counsel for Legg Mason that despite having received what appeared to be a confirmation on the letterhead of the custodian bank stating that Legg Mason had advanced all the money to the nine Subsequently Liquidated

[3] Smith Barney continued to serve as administrator to three Funds until October 19, 2006, whereupon it was replaced by Legg Mason as investment manager of those Funds.

Funds, not all of the advancements had been made. Specifically, two Subsequently Liquidated Funds, the Legg Mason Partners Capital Preservation II Fund ("Capital Preservation II Fund") and the Legg Mason Partners Variable Government Portfolio ("Variable Government Fund") should have received advance payments as described in paragraph 15 of the Plan, but did not.

9. The staff learned that Legg Mason never made the advance payments of approximately $600,000 to the Capital Preservation II Fund and approximately $16,000 to the Variable Government Fund as required by the Plan.[4]

10. On June 4, 2010, the staff learned that the custodian bank confirmation that it had received from Legg Mason, through its counsel, had been fabricated by and at the direction of the CFO and Treasurer for Legg Mason's Fixed Income Funds, Frances Guggino.

11. As CFO and Treasurer for the Fixed Income Funds, Guggino was the person at Legg Mason responsible for ensuring that advances were made to the funds before liquidation; however, in the case of the Capital Preservation II Fund and Variable Government Fund, she failed to do so. Knowing that the Commission staff was seeking confirmation that the payments had been received, Guggino covered up her mistake by directing a subordinate to fabricate a confirmation from the custodian bank that made it appear that all the money had been properly advanced, including to the funds that had failed to receive the advances. Guggino then forwarded that fabricated confirmation to counsel for Legg Mason.

12. In anticipation of receiving the reimbursement from the Fair Fund, Legg Mason's finance department searched for records indicating how much Legg Mason had advanced to each Subsequently Liquated Fund. The finance department personnel could find no record of the approximately $600,000 advancement purportedly made by Legg Mason to the Capital Preservation II Fund. The finance department personnel contacted Guggino for information on the advancement and received her confirmation that the advancement to the Capital Preservation II Fund had been made. In fact, however, as Guggino knew, the advancement had not been made.

13. In the course of her internal communications with Legg Mason employees concerning the advancement to the Capital Preservation II Fund, Guggino offered several different explanations about how the advancement had been made in spite of the fact that there was no evidence of the Capital Preservation II Fund having received the money.

14. In the course of her attempts to persuade finance department personnel that the advancement to the Capital Preservation II Fund had, in fact, been made, Guggino fabricated multiple documents. She altered emails by, for example, cutting and pasting text from one email into another or changing the text that had originally appeared in the email. Among the documents

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[4] The staff also learned that with respect to a third fund, the Legg Mason Partners Variable Equity Index Portfolio, Legg Mason made the advance payment of approximately $30,500, but made it approximately a month after the fund liquidated so that the advanced money was not in fact included as part of the liquidation to fund investors. It appears another Legg Mason employee was responsible for the fact that this advancement not was not made timely.

she altered was a copy of the Capital Preservation II Fund's trial balance. She added entries to the trial balance to make it appear that the Capital Preservation II Fund had received the missing advancement. She then forwarded this altered trial balance to other Legg Mason employees in an effort to persuade them that the advancement had been made. When that attempt was not successful, she altered a copy of Board Meeting Minutes for the Capital Preservation and Capital Preservation II Funds, again to make it appear that the advancement to the Capital Preservation II Fund had been made. Both of these documents – the trial balance and the Board Meeting Minutes – are required books and records of the Capital Preservation II Fund.

15. Finance department personnel were not persuaded by Guggino's explanations and ultimately escalated the matter internally. Legg Mason hired counsel to conduct an investigation and promptly reported its findings to the staff.

**Violations**

16. Section 31(a) of the Investment Company Act and the rules promulgated thereunder require investment companies to maintain and preserve certain books and records. Rule 31a-1(b)(8) under the Investment Company Act requires that investment companies maintain trial balances. Rule 31a-1(b)(4) under the Investment Company Act requires investment companies to maintain, among other things, board meeting minutes. Section 34(a) of the Investment Company Act makes it unlawful for any person "willfully to destroy, mutilate, or alter any account, book, or other document the preservation of which has been required pursuant to section 31(a)…" When Guggino altered copies of these required records and forwarded them as accurate, contemporaneous records, she violated Section 34(a) of the Investment Company Act.

17. As a result of the conduct described above, Guggino willfully violated Section 34(a) of the Investment Company Act.

**IV.**

In view of the foregoing, the Commission deems it appropriate, in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly pursuant to Sections 9(b) and 9(f) of the Investment Company Act and Section 203(f) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Guggino cease and desist from committing or causing any violations and any future violations of Section 34(a) of the Investment Company Act.

B. Respondent Guggino be, and hereby is, barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor or principal underwriter. Any reapplication for association by Guggino will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

C. Respondent Guggino shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $15,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Frances M. Guggino as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Andrew M. Calamari, Acting Regional Director, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, New York, New York 10281.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Lynn M. Powalski
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-67725; File No. 4-652]

**Technology and Trading Roundtable**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Notice of roundtable discussion; request for comment.

**SUMMARY:** The Securities and Exchange Commission will host a one day roundtable entitled "Technology and Trading: Promoting Stability in Today's Markets" to discuss ways to promote stability in markets that rely on highly automated systems. The roundtable will focus on the relationship between the operational stability and integrity of our securities market and the ways in which market participants design, implement, and manage complex and inter-connected trading technologies.

The roundtable discussion will be held in the multi-purpose room of the Securities and Exchange Commission headquarters at 100 F Street, NE, in Washington, DC on September 14, 2012 from 10:00 a.m. to approximately 4:00 p.m. The public is invited to observe the roundtable discussion. Seating will be available on a first-come, first-served basis. The roundtable discussion also will be available via webcast on the Commission's Web site at www.sec.gov.

The roundtable will consist of two panels. The morning panel will focus on error prevention – where technology experts will discuss current best practices and practical constraints for creating, deploying, and operating mission-critical systems, including those that are used to automatically generate and route orders, match trades, confirm transactions, and disseminate data. The afternoon panel will focus on error response – where panelists will discuss how the market might employ independent filters, objective tests, and other real-time processes

or crisis-management procedures to detect, limit, and possibly terminate erroneous market activities when they do occur, thereby limiting the impact of such errors.

**DATES:** The roundtable discussion will take place on September 14, 2012. The Commission will accept comments regarding issues addressed at the roundtable until October 5, 2012.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-652 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submission should refer to File Number 4-652. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/other.shtml). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Arisa Tinaves, Special Counsel, at (202) 551-5676, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Dated: August 24, 2012

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67724 / August 24, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14996**

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| **In the Matter of**<br><br>**SPYGLASS EQUITY SYSTEMS, INC.,**<br><br>**Respondent.** | **ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS** |

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Spyglass Equity Systems, Inc. ("Spyglass" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

**III.**

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Spyglass was a California corporation with its principal place of business in Los Angeles, California. Between October 2007 and March 2009, Spyglass operated as a telemarketing firm purportedly selling automated trading systems.

2. On July 27, 2012, a final judgment was entered by consent against Spyglass, permanently enjoining it from future violations of Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, and from aiding and abetting violations of Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-8 thereunder in the civil action entitled *Securities and Exchange Commission v. Spyglass Equity Systems, Inc.*, Civil Action Number LACV11-02371 JAK, in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that, Spyglass offered and sold to investors memberships in LLCs that would allow access to trading systems and engage in stock trading on behalf of the investors. Spyglass made baseless performance representations, false statements about the stature and integrity of the investment, misrepresentations about the "systems" supposedly used to trade stock on behalf of investors and misrepresentations about the fees to be charged investors. Investors lost over $3 million in the scheme.

## IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Spyglass's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Spyglass be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Lynn M. Powalski
Deputy Secretary

**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67739 / August 28, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14855**

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| **In the Matter of**<br><br>**RYAN MARK REYNOLDS,**<br><br>**Respondent.** | **ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934** |

**I.**

On April 24, 2012, the Securities and Exchange Commission ("Commission") issued an Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Notice of Hearing against Ryan Mark Reynolds ("Respondent" or "Reynolds") (Rel. No. 34-66852).

In connection with these proceedings, Reynolds has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of settling these proceedings and any other proceedings brought by or on behalf of the Commission or in which the Commission is a party, prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. § 201.100 et seq., and without admitting or denying the Commission's findings contained herein, except as to the jurisdiction of the Commission over him and over the subject matter of these proceedings, and the findings contained in Section II. 2 and 3, which are admitted, Respondent Reynolds consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

**II.**

On the basis of this Order and the Respondent's Offer, the Commission finds that:

1. Respondent Reynolds, age 40, resided in Dallas, Texas during 2004. He and another person owned RSMR Capital Group Inc. ("RSMR"), a Texas corporation.

2. Between 1994 and 2001, Reynolds was associated with a broker-dealer registered with the Commission. However, he was sanctioned by the National Association of Securities

Dealers Inc. and then barred from the industry on January 21, 2003. During the relevant period, Reynolds was not registered with the Commission in any capacity.

3. On April 10, 2012, the United States District Court for the Northern District of Texas entered an amended judgment against Reynolds permanently enjoining him from future violations of Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") and Section 15(a)(1) of the Exchange Act. *See SEC v. Phillip W. Offill, Jr., et al.*, Civil Action No. 07-cv-1643-D (N.D. Texas).

4. The Commission's complaint alleged that Reynolds and others violated Sections 5(a) and 5(c) of the Securities Act and Section 15(a)(1) of the Exchange Act. The complaint also alleged that Reynolds engaged in a scheme to evade the registration requirements of the federal securities laws by offering and selling the securities of six companies when no registration statements were filed or in effect for their sales transactions. The complaint also alleged that Reynolds located companies that were interested in raising money by selling shares to investors through the public stock market and acted as an underwriter. The complaint alleged that Reynolds directly and indirectly purchased shares from six companies with a view to offer or sell the shares in connection with distributions of the shares to the public and immediately resold them to public investors through brokerage accounts in the name of RSMR.

5. Further the complaint alleged that Reynolds, through RSMR, acted as an unregistered dealer by engaging in the business of underwriting public securities offerings and engaged in the regular business of buying and selling securities for his own accounts. The complaint also alleged that Reynolds used the mails or the means or instrumentalities of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of securities while he was not registered with the Commission as a broker-dealer or associated with a broker-dealer registered with the Commission.

6. At all relevant times when Reynolds engaged in the offer, sale or purchase of securities, he was not registered as a dealer or associated with a dealer registered with the Commission.

7. Section 15(a)(1) of the Exchange Act makes it unlawful for any broker or dealer to use the means of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security unless such broker or dealer is registered with the Commission in accordance with Section 15(b) of the Exchange Act, or in the case of a natural person, is associated with a registered broker-dealer. Section 3(a)(5)(A) of the Exchange Act defines a "dealer" as "any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise."

## III.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in the Respondent's Offer.

Accordingly, it is ORDERED that pursuant to Section 15(b)(6) of the Exchange Act, Respondent Reynolds be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67744 / August 28, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14998**

**In the Matter of**

**EDWARD A. ALLEN,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

## I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Edward A. Allen ("Allen" or "Respondent").

## II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Since at least September 2005, Respondent has been the Chief Executive Officer of A&O Investments, LLC ("A&O"), a Florida limited liability company with its principal place of business in Lakeland, Florida. From December 2003 until he resigned in June 2007, Allen also was a registered representative associated with World Group Securities, Inc. ("WGS"), a broker-dealer registered with the Commission. Respondent is 35 years old, and is a resident of Auburndale, Florida.

2. On June 25, 2012, a judgment was entered against Allen, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Edward A. Allen, et al., Civil Action Number 1:10-cv-1143, in the United States District Court for the Northern District of Ohio.

3. The Commission's complaint alleged that, from at least September 2005 until December 2008, Allen and his business partner raised approximately $14.8 million from at least 100 investors through the offer and sale of unregistered securities in the form of promissory notes issued by A&O and several other related entities. The complaint further alleged that Allen and his partner solicited WGS customers to become investors while they were working at WGS and after they had left the firm. According to the complaint, Allen knowingly made material misrepresentations and omitted to state material facts about the use of investor funds, the risks of the investments, and the safety of investor funds. Among other things, Allen told investors that he and his partner would use the investors' money to purchase, rehabilitate, and sell real estate. He promised to pay investors annual returns of 20 percent, represented that the returns were generated from the sale of A&O's real estate properties, and told investors that he and his partner were doing well in the real estate market and were making money. The complaint further alleged that, in reality, Allen and his partner operated a Ponzi scheme by using approximately $4.4 million of investor funds to pay "interest" and, in some cases, principal to previous investors. They spent only $5.1 million of the $14.8 million raised to purchase and rehabilitate real estate, and used $2.2 million to pay personal expenses for themselves and their family members. Finally, the complaint alleged that Allen and his partner misrepresented and omitted to state material facts regarding the collateral securing the notes. As much as approximately $5.5 million worth of A&O promissory notes purportedly were secured by the same piece of property at 5124 Windover Lane in Lakeland, Florida. As alleged in the complaint, the property's value was grossly inadequate to secure the notes.

4. Allen also has pled guilty to criminal conduct relating to the matters alleged in the civil complaint. Specifically, in *United States v. Allen*, Crim. No. 4:11-cr-00255 (N.D. Ohio.), Defendant pled guilty to Conspiracy to Commit Wire and Mail Fraud [18 U.S.C. § 1349] and Conspiracy to Launder Money [18 U.S.C. § 1956(h)]. In connection with that plea, Defendant admitted the facts set out in his plea agreement.

## IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Allen's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Allen be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and
>
> barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

**INVESTMENT ADVISERS ACT OF 1940**
**Release No. 3450 / August 28, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14997**

| In the Matter of<br><br>Candice D. Campbell,<br><br>Respondent. | ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 |
|---|---|

## I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Candice D. Campbell ("Respondent" or "Campbell").

## II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Beginning in or before April 2009 through August 2010, Respondent was the purported CFO of CJ's Financial ("CJF"), a so-called "investment firm" with no legal status as a business in any state but located in Canton, Michigan. Respondent is 33 years old, and currently is a resident of Garden City, Michigan. From April 2009 through August 2010, Campbell acted as an unregistered investment adviser in violation of the federal securities laws.

B. ENTRY OF THE CONVICTION

2. On July 20, 2011, the United States Attorney for the Eastern District of Michigan filed a first superseding criminal information against Campbell, charging her with one count of wire fraud. *United States v. Campbell*, 2:11-cr-20388 (E.D. Mich.). That action involves the same conduct previously alleged in a complaint filed by the Commission in August 2010. *SEC v. C.J.'s Financial and Candice Campbell*, 2:10-cv-13083 (E.D. Mich.). On January 23, 2012, Campbell pleaded guilty to one count of wire fraud, and was sentenced to 51 months in prison and ordered to pay restitution in the amount of $835,474.10. *United States v. Campbell*, 2:11-cr-20388 (E.D. Mich.) (Docket No. 15).

3. By pleading guilty in the criminal case, Campbell admitted that, as the owner and controller of Defendant CJF, she: (i)"devised a scheme to defraud in order to obtain money or property as described in the first superseding information," (ii) the "scheme included a material misrepresentation or concealment of a material fact," (iii) she "had the intent to defraud," and (iv) she "used wire, radio or television communications ... in interstate commerce in furtherance of the scheme."

**III.**

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

**IV.**

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against her upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

**UNITED STATES OF AMERICA**
**before the**
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67749 / August 29, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-15000**

| | | |
|---|---|---|
| **In the Matter of** | : | |
| | : | |
| **GARY B. WOLFF, ESQ.,** | : | **ORDER OF SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE** |
| **Respondent.** | : | |

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate to issue an order of forthwith suspension of Gary B. Wolff ("Wolff") pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 200.102(e)(2)].[1]

**II.**

The Commission finds that:

1. Wolff was an attorney licensed to practice law in New York.

2. On October 21, 2010, the Supreme Court of New York, Appellate Division, First Judicial Department, issued an order suspending Wolff from the practice of law until further order of that court.

3. As of August 28, 2012, Wolff has not been reinstated to the practice of law in New York.

**III.**

In view of the foregoing, the Commission finds that Wolff has been suspended by a court within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

[1] Rule 102(e)(2) provides in pertinent part: "Any attorney who has been suspended or disbarred by a court of the United States or of any State . . . shall be forthwith suspended from appearing or practicing before the Commission."

Accordingly, it is ORDERED that Wolff is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Disapproved

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PARTS 230 and 239**

**[Release No. 33-9354; File No. S7-07-12]**

**RIN 3235-AL34**

# ELIMINATING THE PROHIBITION AGAINST GENERAL SOLICITATION AND GENERAL ADVERTISING IN RULE 506 AND RULE 144A OFFERINGS

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** We are proposing amendments to Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933 to implement Section 201(a) of the Jumpstart Our Business Startups Act. The proposed amendment to Rule 506 would provide that the prohibition against general solicitation and general advertising contained in Rule 502(c) of Regulation D would not apply to offers and sales of securities made pursuant to Rule 506, provided that all purchasers of the securities are accredited investors. The proposed amendment to Rule 506 would also require that, in Rule 506 offerings that use general solicitation or general advertising, the issuer take reasonable steps to verify that purchasers of the securities are accredited investors. The proposed amendment to Rule 144A(d)(1) would provide that securities may be offered pursuant to Rule 144A to persons other than qualified institutional buyers, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are qualified institutional buyers. We are also proposing to revise Form D to add a separate check box for issuers to indicate whether they are using general solicitation or general advertising in a Rule 506 offering.

**DATES:** Comments should be received on or before [30 days after publication in the

Federal Register].

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml);
- Send an email to rule-comments@sec.gov. Please include File Number S7-07-12 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-07-12. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549-1090 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Charles Kwon, Special Counsel, or Ted Yu, Senior Special Counsel, Office of Chief Counsel, Division of Corporation Finance, at (202) 551-3500, or, with respect to privately offered funds, Holly Hunter-Ceci, Senior Counsel, Office of Chief Counsel, or Alpa Patel, Attorney-Adviser, Private Funds Branch, Office of Investment Adviser Regulation, Division of Investment Management, at (202) 551-6825 or (202) 551-6787, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

**SUPPLEMENTARY INFORMATION:** We are proposing amendments to Rule 144A,[1] Form D,[2] and Rules 500,[3] 501,[4] 502[5] and 506[6] of Regulation D[7] under the Securities Act of 1933.[8]

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[1] 17 CFR 230.144A.

[2] 17 CFR 239.500.

[3] 17 CFR 230.500.

[4] 17 CFR 230.501.

[5] 17 CFR 230.502.

[6] 17 CFR 230.506.

[7] 17 CFR 230.500 through 230.508.

[8] 15 U.S.C. 77a et seq.

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## I. INTRODUCTION

The Jumpstart Our Business Startups Act (the "JOBS Act") was enacted on April 5, 2012.[9] Section 201(a)(1) of the JOBS Act directs the Commission, not later than 90 days after the date of enactment, to amend Rule 506 of Regulation D[10] under the

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[9] Pub. L. No. 112-106, 126 Stat. 306.

[10] The Commission adopted Regulation D in 1982 as a result of the Commission's evaluation of the impact of its rules on the ability of small businesses to raise capital. See Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, Release No. 33-6389 (Mar. 8, 1982) [47 FR 11251]. Over the years, the Commission has revised various provisions of Regulation D in order to address, among other things, specific concerns relating to facilitating capital-raising as well as abuses that have arisen under Regulation D. See, e.g., Additional Small Business Initiatives, Release No. 33-6996

Securities Act of 1933 (the "Securities Act") to permit general solicitation or general advertising in offerings made under Rule 506, provided that all purchasers of the securities are accredited investors. Section 201(a)(1) also states that "[s]uch rules shall require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission." Section 201(a)(2) of the JOBS Act directs the Commission, not later than 90 days after the date of enactment, to revise Rule 144A(d)(1)[11] under the Securities Act to permit offers of securities pursuant to Rule 144A to persons other than qualified institutional buyers ("QIBs"),[12] including by means of general solicitation or general advertising, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs.

Rule 506 is a non-exclusive safe harbor under Section 4(a)(2) (formerly Section 4(2)) of the Securities Act,[13] which exempts transactions by an issuer "not involving any public offering" from the registration requirements of Section 5 of the Securities Act.[14] Under existing Rule 506, an issuer may offer and sell securities, without any limitation on the offering amount, to an unlimited number of "accredited investors," as defined in Rule

(Apr. 28, 1993) [58 FR 26509] and Revision of Rule 504 of Regulation D, the "Seed Capital" Exemption, Release No. 33-7644 (Feb. 25, 1999) [64 FR 11090].

[11] 17 CFR 230.144A(d)(1).

[12] The term "qualified institutional buyer" is defined in Rule 144A(a)(1) [17 CFR 230.144A(a)(1)] and includes specified institutions that, in the aggregate, own and invest on a discretionary basis at least $100 million in securities of issuers that are not affiliated with such institutions. Banks and other specified financial institutions must also have a net worth of at least $25 million. A registered broker-dealer qualifies as a QIB if it, in the aggregate, owns and invests on a discretionary basis at least $10 million in securities of issuers that are not affiliated with the broker-dealer.

[13] 15 U.S.C. 77d(a)(2).

[14] 15 U.S.C. 77e.

501(a) of Regulation D,[15] and to no more than 35 non-accredited investors who meet certain "sophistication" requirements.[16] The availability of the Rule 506 safe harbor is subject to a number of requirements[17] and is currently conditioned on the issuer, or any person acting on its behalf, not offering or selling securities through any form of "general solicitation or general advertising."[18] Although the terms "general solicitation" and "general advertising" are not defined in Regulation D, Rule 502(c) does provide examples of general solicitation and general advertising, including advertisements published in newspapers and magazines, communications broadcast over television and radio, and seminars whose attendees have been invited by general solicitation or general advertising.[19] By interpretation, the Commission has confirmed that other uses of publicly available media, such as unrestricted websites, also constitute general solicitation and general advertising.[20] In this release, we will refer to both general solicitation and general advertising as "general solicitation."

Rule 144A is a non-exclusive safe harbor exemption from the registration

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[15] The definition of the term "accredited investor" is set forth in Rule 501(a) of Regulation D [17 CFR 230.501(a)] and includes any person who comes within one of the definition's enumerated categories of persons, or whom the issuer "reasonably believes" comes within any of the enumerated categories, at the time of the sale of the securities to that person.

[16] Under Rule 506(b)(2)(ii) [17 CFR 230.506(b)(2)(ii)], each purchaser in a Rule 506 offering who is not an accredited investor must possess, or the issuer must reasonably believe immediately before the sale that such purchaser possesses, either alone or with his or her purchaser representative, "such knowledge and experience in financial and business matters that he [or she] is capable of evaluating the merits and risks of the prospective investment."

[17] Offerings under Rule 506 are subject to all the terms and conditions of Rules 501 and 502. If securities are sold to any non-accredited investors, specified information requirements apply. See Rule 502(b) [17 CFR 230.502(b)].

[18] Rule 502(c) of Regulation D [17 CFR 230.502(c)].

[19] Id.

[20] See Use of Electronic Media for Delivery Purposes, Release No. 33-7233 (Oct. 6, 1995) [60 FR 53458] at Ex. 20; Use of Electronic Media, Release No. 33-7856 (Apr. 28, 2000) [65 FR 25843] at footnotes 79-80 and accompanying text.

requirements of the Securities Act for resales of certain "restricted securities"[21] to QIBs. Resales to QIBs in accordance with the conditions of Rule 144A[22] are exempt from registration pursuant to Section 4(a)(1) (formerly Section 4(1)) of the Securities Act,[23] which exempts transactions by any person "other than an issuer, underwriter, or dealer." Although Rule 144A does not include an express prohibition against general solicitation, offers of securities under Rule 144A currently must be limited to QIBs, which has the same practical effect. By its terms, Rule 144A is available solely for resale transactions; however, since its adoption by the Commission in 1990, market participants have used Rule 144A to facilitate capital-raising by issuers. The term "Rule 144A offering" in this release refers to a primary offering of securities by an issuer to one or more financial intermediaries – commonly known as the "initial purchasers" – in a transaction that is exempt from registration pursuant to Section 4(a)(2) or Regulation S,[24] followed by the immediate resale of those securities by the initial purchasers to QIBs in reliance on Rule 144A.

Rule 506 offerings and Rule 144A offerings are widely used by U.S. and foreign

[21] "Restricted securities" are defined in Securities Act Rule 144(a)(3) [17 CFR 230.144(a)(3)] to include, in part, "[s]ecurities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a chain of transactions not involving a public offering."

[22] In order for a transaction to come within existing Rule 144A, a seller must have a reasonable basis for believing that the offeree or purchaser is a QIB and must take reasonable steps to ensure that the purchaser is aware that the seller may rely on Rule 144A. Further, only securities that were not, when issued, of the same class as securities listed on a U.S. securities exchange or quoted on a U.S. automated interdealer quotation system are eligible for resale under Rule 144A. Also, the seller and a prospective purchaser designated by the seller must have the right to obtain from the issuer, upon request, certain information on the issuer, unless the issuer falls within specified categories as to which this condition does not apply.

[23] 15 U.S.C. 77d(a)(1).

[24] Regulation S under the Securities Act [17 CFR 230.901 through 230.905] was adopted in 1990 as a safe harbor from the registration requirements of the Securities Act for any offer or sale of securities made outside the United States. It provides that any "offer," "offer to sell," "sell," "sale" or "offer to buy" that occurs outside the United States is not subject to the registration requirements of Section 5. Regulation S does not limit the scope or availability of the antifraud or other provisions of the Securities Act to offers and sales made in reliance on Regulation S.

issuers to raise capital. In 2011, the estimated amount of capital (including both equity and debt) raised in Rule 506 offerings and Rule 144A offerings was $895 billion and $168 billion, respectively, compared to $984 billion raised in registered offerings. In 2010, the estimated amount of capital (including both equity and debt) raised in Rule 506 offerings and Rule 144A offerings was $902 billion and $233 billion, respectively, compared to $1.07 trillion raised in registered offerings.[25] These data points underscore the importance of the Rule 506 and Rule 144A exemptions for issuers seeking access to the U.S. capital markets.

To implement Section 201(a) of the JOBS Act, we are proposing to amend Rule 506 to provide that the prohibition against general solicitation contained in Rule 502(c) shall not apply to offers and sales of securities made pursuant to Rule 506, as amended, provided that all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that the purchasers are accredited investors. In addition, we are proposing to amend Form D, which is a notice required to be filed with the Commission by each issuer claiming a Regulation D exemption, to add a check box to indicate whether an offering is being conducted pursuant to the proposed amendment to Rule 506

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[25] These statistics are based on a review of Form D electronic filings with the Commission – specifically, the "total amount sold" as reported in Form D – and data regarding other types of offerings (e.g., public debt offerings and Rule 144A offerings) from Securities Data Corporation's New Issues database (Thomson Financial). See Vlad Ivanov and Scott Bauguess, Capital Raising in the U.S.: The Significance of Unregistered Offerings Using the Regulation D Exemption (Feb. 2012) (the "Ivanov/Bauguess Study"), available at: http://www.sec.gov/info/smallbus/acsec/acsec103111_analysis-reg-d-offering.pdf. The amount of capital raised through offerings under Regulation D may be considerably larger than what is reported on Form D because, although the filing of a Form D is a requirement of Rule 503(a) of Regulation D [17 CFR 230.503(a)], it is not a condition to the availability of the exemptions under Regulation D. Further, once a Form D is filed, the issuer is not required to file an amendment to the notice to reflect a change that occurs after the offering terminates or a change that occurs solely with respect to certain information, such as the amount sold in the offering. For example, if the amount sold does not exceed the offer size by more than 10% or the offer closes within a year, the filing of an amendment to the initial Form D is not required. Therefore, a Form D filed for a particular offering may not reflect the total amount of securities sold in the offering in reliance on the exemption.

that would permit general solicitation. We are also proposing to amend Rule 144A to provide that securities sold pursuant to Rule 144A may be offered to persons other than QIBs, including by means of general solicitation, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs.

We have considered comment letters received to date on Section 201(a) of the JOBS Act, and we are requesting comment on various issues relating specifically to the proposed amendments described above.[26] In this release, we are proposing only those rule and form amendments that are, in our view, necessary to implement the mandate in Section 201(a). We recognize that commentators have urged us to consider and propose other amendments to Regulation D or to Form D that they believe are appropriate in connection with implementation of the rule and form amendments proposed here. For example, several commentators have recommended that the Commission also amend the definition of "accredited investor" as it relates to natural persons.[27] Other commentators

[26] To facilitate public input on JOBS Act rulemaking before the issuance of rule proposals, the Commission has invited members of the public to make their views known on various JOBS Act initiatives in advance of any rulemaking by submitting comment letters to the Commission's website at http://www.sec.gov/spotlight/jobsactcomments.shtml. Comment letters received to date on Section 201(a) of the JOBS Act are available at http://www.sec.gov/comments/jobs-title-ii/jobs-title-ii.shtml, and we cite to many of them in this release. Comment letters on this release should be submitted as directed in "Addresses" above.

[27] See letters from Cambridge Innovation Center (suggesting that the Commission consider offering investor education classes whereby investors who meet a lower financial threshold but pass a qualifying test could be granted accredited investor status); Fund Democracy, Consumer Federation of America, Consumer Action, AFL-CIO, and Americans for Financial Reform ("Fund Democracy") (recommending higher financial thresholds for natural persons claiming to be accredited investors); Investment Company Institute ("ICI") (May 21, 2012) (recommending increased income and net worth thresholds in the accredited investor definition and inclusion of a new category of "accredited natural persons" in the accredited investor definition); Managed Funds Association ("MFA") (May 4, 2012) (recommending adding "knowledgeable employee" under the Investment Company Act to the definition of "accredited investor"); Public Citizen (recommending higher income and net worth thresholds in the accredited investor definition); Office of the Secretary of the Commonwealth of Massachusetts Securities Division ("Massachusetts Securities Division") (same); Ilan Moscovitz and John Maxfield ("Moscovitz and Maxfield") (same); Ohio Division of Securities ("Ohio Division") (same). One commentator opposed

have suggested that we amend the Form D filing requirement, including conditioning the availability of the proposed Rule 506 exemption on the filing of Form D,[28] requiring the Form D to be filed in advance of any general solicitation,[29] and adding to the information requirements of Form D.[30] Other commentators have suggested that we propose rules governing the content and manner of advertising and solicitations used in offerings conducted under the proposed Rule 506 exemption,[31] particularly with respect to privately offered funds.[32]

We appreciate the suggestions made by these commentators; however, at this time, we are not proposing these or any other amendments to Regulation D or to Form D.

## II. PROPOSED AMENDMENTS TO RULE 506 AND FORM D

### A. Eliminating the Prohibition Against General Solicitation

Section 4(a)(2) exempts transactions by an issuer "not involving any public

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increasing the thresholds for accredited investor status. See letter from National Small Business Association ("NSBA") (June 12, 2012).

[28] See letters from Massachusetts Securities Division ("The filing of a Form D should be a condition of the availability of the new Rule 506 exemption."); North American Securities Administrators Association, Inc. ("NASAA") (July 3, 2012) (recommending that the failure to file a Form D prior to the use of general solicitation must result in the loss of the exemption and warning that without such a filing requirement, regulators would "have no way of knowing whether a promoter is legitimately trying to comply with Rule 506, so a fraudulent offering will be allowed to continue until the regulators have gathered sufficient evidence to prove fraud has already occurred").

[29] See letters from Fund Democracy; NASAA (July 3, 2012); Public Citizen.

[30] See, e.g., letters from NASAA (July 3, 2012) (listing a number of recommended amendments to Form D, such as the disclosure of the issuer's website address); Ohio Division (recommending that Form D provide more background information to allow broker-dealers, regulators, and investors to assess whether an issuer has been disqualified from using Rule 506).

[31] Letters from NASAA (July 3, 2012) (stating that advertising materials used in Rule 506 offerings should include a "balanced presentation of risks and rewards" and be subject to a requirement that statements in the advertising materials are consistent with representations in the offering documents); Ohio Division (recommending that, among other things, the Commission adopt a uniform set of required disclosures and content restrictions for general solicitation materials, such as a mandatory legend disclosing those jurisdictions where the offering is being made (and disclaiming sales in any others) and a prohibition on financial projections or statements of future performance).

[32] See, e.g., letters from ICI (May 21, 2012); Moscovitz and Maxfield; and Fund Democracy (Aug. 16, 2012).

offering." An issuer relying on Section 4(a)(2) is restricted in its ability to make public communications to attract investors for its offering because public advertising is incompatible with a claim of exemption under Section 4(a)(2).[33] As noted above, Rule 506 currently conditions the availability of the safe harbor under Section 4(a)(2) on the issuer, or any person acting on its behalf, not offering or selling securities through any form of general solicitation.[34] Section 201(a)(1) of the JOBS Act directs the Commission to amend Rule 506 to provide that the prohibition against general solicitation contained in Rule 502(c) shall not apply to offers and sales of securities made pursuant to Rule 506, as so amended, provided that purchasers of the securities are accredited investors. This mandate affects only the Rule 506 safe harbor, and not Section 4(a)(2) offerings in general.[35]

To implement the mandated rule change, we are proposing new Rule 506(c), which would permit the use of general solicitation to offer and sell securities under Rule 506, provided that certain conditions are satisfied.[36] These conditions are:

- the issuer must take reasonable steps to verify that the purchasers of the securities are accredited investors;
- all purchasers of securities must be accredited investors, either because they come within one of the enumerated categories of persons that qualify as

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[33] See Non-Public Offering Exemption, Release No. 33-4552 (Nov. 6, 1962) [27 FR 11316].

[34] See Rule 502(c) and Rule 506(b)(1) of Regulation D [17 CFR 230.506(b)(1)].

[35] In this regard, we note that bills that would have amended Section 4(a)(2) itself to permit the use of general solicitation were introduced and considered by Congress but not enacted. See Access to Capital for Job Creators, H.R. 2940, 112th Cong. (2011) (proposing to amend Section 4(a)(2) by adding the phrase "whether or not such transactions involve general solicitation or general advertising"); Access to Capital for Job Creators, S.1831, 112th Cong. (2011) (same).

[36] We note that broker-dealers participating in offerings in conjunction with issuers relying on proposed Rule 506(c) would continue to be subject to the rules of the Financial Industry Regulatory Authority ("FINRA") regarding communications with the public. See FINRA Rule 2210.

accredited investors or the issuer reasonably believes that they do, at the time of the sale of the securities;[37] and

- all terms and conditions of Rule 501 and Rules 502(a) and 502(d) must be satisfied.[38]

Offerings under proposed Rule 506(c) would not be subject to the requirement to comply with Rule 502(c), which contains the prohibition against general solicitation.[39]

While we are proposing Rule 506(c) to allow for Rule 506 offerings that use general solicitation, we are preserving, under existing Rule 506(b), the existing ability of issuers to conduct Rule 506 offerings without the use of general solicitation. We recognize that offerings under existing Rule 506 represent an important source of capital for issuers of all sizes and believe that the continued availability of existing Rule 506 will be important for those issuers that either do not wish to engage in general solicitation in their Rule 506 offerings (and become subject to the new requirement to take reasonable steps to verify the accredited investor status of purchasers) or wish to sell privately to non-accredited investors who meet Rule 506(b)'s sophistication requirements. Retaining the safe harbor under existing Rule 506 may also be beneficial to investors with whom an

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[37] Rule 501(a) of Regulation D.

[38] Securities acquired under proposed Rule 506(c) would be subject to the resale limitations under Rule 502(d) [17 CFR 230.502(d)] and therefore would be "restricted securities" as defined in Rule 144(a)(3)(ii) [17 CFR 230.144(a)(3)(ii)]. Further, Section 201(b) of the JOBS Act added Section 4(b) of the Securities Act, which provides that "[o]ffers and sales exempt under [Rule 506 as amended pursuant to Section 201 of the JOBS Act] shall not be deemed public offerings under the Federal securities laws as a result of general advertising or general solicitation." Thus, securities acquired under proposed Rule 506(c) would also meet the definition of "restricted securities" under Rule 144(a)(3)(i) [17 CFR 230.144(a)(3)(i)] ("[s]ecurities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering").

[39] Offerings under proposed Rule 506(c) would also not be subject to the information requirements in Rule 502(b), because all purchasers in proposed Rule 506(c) offerings would be accredited investors.

issuer has a pre-existing substantive relationship.[40] In this regard, we do not believe that Section 201(a) requires the Commission to modify Rule 506 to impose any new requirements on offers and sales of securities that do not involve general solicitation. Therefore, the amendments to Rule 506 we are proposing today would not amend or modify the requirements relating to existing Rule 506.

### B. Reasonable Steps to Verify Accredited Investor Status

While Section 201(a)(1) of the JOBS Act mandates that our amendments to Rule 506 require issuers using general solicitation in Rule 506 offerings "to take reasonable steps to verify that purchasers of the securities are accredited investors," it does not specify the methods necessary to satisfy this requirement and instead requires issuers to use "such methods as determined by the Commission." We believe that the purpose of the verification mandate is to address concerns, and reduce the risk, that the use of general solicitation under Rule 506 may result in sales to investors who are not, in fact, accredited investors.[41] We also recognize, however, that it would be necessary that our proposed amendment to Rule 506 provide sufficient flexibility to accommodate the

[40] In a series of no-action and interpretive letters, the Commission staff has indicated that an issuer would not contravene Rule 502(c)'s prohibition against general solicitation if the issuer has a pre-existing substantive relationship with the offerees. See, e.g., Mineral Lands Research and Marketing Corp. (Nov. 3, 1985). The Commission staff has also addressed how an intermediary, such as a broker-dealer acting as a placement agent, can establish a sufficient pre-existing substantive relationship with its customers such that there would be no general solicitation when an issuer engages that intermediary to offer securities to the intermediary's customers. See, e.g., E.F. Hutton & Co. (Dec. 3, 1985). The framework set forth by this staff guidance on pre-existing substantive relationships has also provided flexibility in the use of the Internet in Regulation D offerings. See, e.g., IPONET (July 26, 1996); Lamp Technologies, Inc. (May 29, 1998).

[41] See, e.g., Markup of H.R. 2940, Access to Capital for Job Creators Act, Subcommittee on Capital Markets and Government Sponsored Enterprises, House Financial Services Committee, 112th Cong. (Oct. 5, 2011) (remarks of Representative Waters, explaining that she is introducing the amendment that requires issuers to take reasonable steps to verify accredited investor status because "we must take steps to ensure that those folks are indeed sophisticated"); 157 Cong. Rec. H7291 (daily ed. Nov. 3, 2011) (remarks of Representative Maloney (same)); 157 Cong. Rec. H7294 (daily ed. Nov. 3, 2011) (remarks of Representative Lee (same)).

different types of issuers that would conduct offerings under proposed Rule 506(c) and the different types of accredited investors (such as natural persons, public and private for-profit and not-for-profit corporations, general and limited partnerships, business and other types of trusts, and funds and other types of collective investment vehicles) that may purchase securities in these offerings.

We are proposing a requirement in Rule 506(c) that issuers using general solicitation "take reasonable steps to verify" that the purchasers of the offered securities are accredited investors. Whether the steps taken are "reasonable" would be an objective determination, based on the particular facts and circumstances of each transaction.

Under this proposed approach, issuers would consider a number of factors when determining the reasonableness of the steps to verify that a purchaser is an accredited investor. Some examples of these factors include:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be;
- the amount and type of information that the issuer has about the purchaser; and
- the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount.

We discuss each of these factors in greater detail below.

Nature of the Purchaser. The definition of "accredited investor" in Rule 501(a) includes natural persons and entities that come within any of eight enumerated categories in the rule, or that the issuer reasonably believes come within one of those categories, at the time of the sale of securities to that natural person or entity. Some purchasers may be accredited investors based on their status, such as:

- a broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934 (the "Exchange Act");[42] or
- an investment company registered under the Investment Company Act of 1940 (the "Investment Company Act") or a business development company as defined in Section 2(a)(48) of that Act.[43]

Some purchasers may be accredited investors based on a combination of their status and the amount of their total assets, such as:

- a plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of $5 million;[44] or
- an Internal Revenue Code ("IRC") Section 501(c)(3) organization, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5 million.[45]

Natural persons may be accredited investors based on either their net worth or their annual income, as follows:

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[42] See 17 CFR 230.501(a)(1).

[43] See id.

[44] See id.

[45] See 17 CFR 230.501(a)(3).

- a natural person whose individual net worth, or joint net worth with that person's spouse, exceeds $1 million, excluding the value of the person's primary residence (the "net worth test");[46] or
- a natural person who had an individual income in excess of $200,000 in each of the two most recent years, or joint income with that person's spouse in excess of $300,000 in each of those years, and has a reasonable expectation of reaching the same income level in the current year (the "income test").[47]

As Rule 501(a) sets forth different categories of accredited investors, we expect the steps that would be reasonable for an issuer to take to verify whether a purchaser is an accredited investor under proposed Rule 506(c) would likely vary depending on the type of accredited investor that the purchaser claims to be. For example, the steps that may be reasonable to verify that an entity is an accredited investor by virtue of being a registered broker-dealer – such as by going to FINRA's BrokerCheck website[48] – would necessarily differ from the steps that would be reasonable to verify whether a natural person is an accredited investor.

We recognize that taking reasonable steps to verify the accredited investor status of natural persons poses greater practical difficulties as compared to other categories of accredited investors, and these practical difficulties likely would be exacerbated by natural persons' privacy concerns about the disclosure of personal financial

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[46] See 17 CFR 230.501(a)(5).

[47] See 17 CFR 230.501(a)(6).

[48] This website is available at http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/.

information.[49] As between the net worth test and the income test for natural persons, we recognize that commentators have suggested that it might be more difficult for an issuer to obtain information about a person's assets and liabilities than it would be to obtain information about a person's annual income,[50] although there could be privacy concerns with respect to either test. The question of what type of information would be sufficient to constitute reasonable steps to verify accredited investor status under the particular facts and circumstances of each purchaser would also depend on other factors, as described below.

Information about the Purchaser. The amount and type of information that an issuer has about a purchaser would be a significant factor in determining what additional steps would be reasonable to verify the purchaser's accredited investor status. The more information an issuer has indicating that a prospective purchaser is an accredited investor, the fewer steps it would have to take, and vice versa.[51] Examples of the types of information that issuers could review or rely upon – any of which might, depending on

[49] See, e.g., letters from BrokerBank Securities, Inc. ("BrokerBank") ("By the time most people accumulate a net worth of $1,000,000+ not counting their principal residence, they usually really want to keep their financial information very close to the vest."); Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association ("ABA") (stating that "the Commission should be sensitive to the legitimate privacy concerns of purchasers" when considering the steps that issuers should take to verify accredited investor status); SecondMarket Holdings, Inc. ("SecondMarket") ("In addition, legitimate privacy concerns may result in potential investors being unwilling to provide highly sensitive personal information outside of a clearly protective framework, which may cause such investors to avoid participating in Rule 506 offerings.").

[50] See letters from NASAA (July 3, 2012) ("Verification of net worth is more challenging because an individual could provide proof of assets but not liabilities."); SecondMarket (indicating that, in its experience, the majority of natural persons who indicated that they were accredited investors did so based on the income test of Rule 501(a)(6), which can be verified through tax returns, Form W-2, Form 1099, or other income documentation, in addition to a pay stub from the current year, whereas verifying that a purchaser satisfies the net worth test may be very difficult; therefore, this commentator recommended that a "substantial minimum investment requirement," coupled with representations by the purchaser, should be deemed sufficient evidence to presume that a purchaser satisfies the net worth test without requiring additional verification of that purchaser's accredited investor status).

[51] If an issuer has actual knowledge that the purchaser is an accredited investor, then the issuer would not have to take any steps at all.

the circumstances, in and of themselves constitute reasonable steps to verify a purchaser's accredited investor status – include, without limitation:

- publicly available information in filings with a federal, state or local regulatory body – for example, without limitation:
  - the purchaser is a named executive officer of an Exchange Act registrant, and the registrant's proxy statement discloses the purchaser's compensation for the last three completed fiscal years; or
  - the purchaser claims to be an IRC Section 501(c)(3) organization with $5 million in assets, and the organization's Form 990 series return filed with the Internal Revenue Service discloses the organization's total assets;[52]
- third-party information that provides reasonably reliable evidence that a person falls within one of the enumerated categories in the accredited investor definition – for example, without limitation:
  - the purchaser is a natural person and provides copies of Forms W-2; or
  - the purchaser works in a field where industry or trade publications disclose average annual compensation for certain levels of employees or partners, and specific information about the average compensation earned at the purchaser's workplace by persons at the level of the purchaser's seniority is publicly available; or

[52] Such an organization is required to make the Form 990 series returns available for public inspection. See Internal Revenue Service, Public Disclosure and Availability of Exempt Organizations Returns and Applications: Documents Subject to Public Disclosure, http://www.irs.gov/charities/article/0,,id=135008,00.html (last updated Sept. 21, 2011).

- verification of a person's status as an accredited investor by a third party, such as a broker-dealer, attorney or accountant, provided that the issuer has a reasonable basis to rely on such third-party verification.[53]

Nature and Terms of the Offering. The nature of the offering – such as the means through which the issuer publicly solicits purchasers – may be relevant in determining the reasonableness of the steps taken to verify accredited investor status. An issuer that solicits new investors through a website accessible to the general public or through a widely disseminated email or social media solicitation would likely be obligated to take greater measures to verify accredited investor status than an issuer that solicits new investors from a database of pre-screened accredited investors created and maintained by a reasonably reliable third party, such as a registered broker-dealer. In the case of the former, we do not believe that an issuer would have taken reasonable steps to verify accredited investor status if it required only that a person check a box in a questionnaire or sign a form, absent other information about the purchaser indicating accredited investor status. In the case of the latter, we believe an issuer would be entitled to rely on

[53] For example, in the future, services may develop that verify a person's accredited investor status for purposes of proposed Rule 506(c) and permit issuers to check the accredited investor status of possible investors, particularly for web-based Rule 506 offering portals that include offerings for multiple issuers. This third-party service, as opposed to the issuer itself, could obtain appropriate documentation or otherwise verify accredited investor status. Several commentators, in fact, have recommended that the Commission take action to facilitate the ability of issuers to rely on third parties to perform the necessary verification. See letters from NASAA (July 3, 2012) (recommending that the Commission allow an issuer to obtain the necessary verification through registered broker-dealers, provided that there are independent liability provisions for failure to adequately perform the verification); Massachusetts Securities Division (urging the Commission to adopt as a safe harbor or best practice the use of an independent party, such as a broker-dealer, bank, or other financial institution, that would verify the accredited investor status of potential purchasers). One commentator, however, expressed concerns that some of the websites that currently offer lists of accredited investors could be used to facilitate fraud, noting that some offer lists based on "ethnicity, gender, and lifestyle – presumably to make [it] easier for scammers to relate to marks – and ominously, 'seniors.'" Letter from Moscovitz and Maxfield.

a third party that has verified a person's status as an accredited investor, provided that the issuer has a reasonable basis to rely on such third-party verification.

The terms of the offering would also affect whether the verification methods used by the issuer are reasonable. Some commentators have expressed the view that a purchaser's ability to meet a high minimum investment amount could be relevant to the issuer's evaluation of the types of steps that would be reasonable to take in order to verify that purchaser's status as an accredited investor.[54] We believe that there is merit to this view. By way of example, the ability of a purchaser to satisfy a minimum investment amount requirement that is sufficiently high such that only accredited investors could reasonably be expected to meet it, with a direct cash investment that is not financed by the issuer or by any other third party, could be taken into consideration in verifying accredited investor status.

These factors are interconnected, and the information gained by looking at these factors would help an issuer assess the reasonable likelihood that a potential purchaser is an accredited investor, which would, in turn, affect the types of steps that would be reasonable to take to verify a purchaser's accredited investor status. After consideration of the facts and circumstances of the purchaser and of the transaction, if it appears likely

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[54] See, e.g., letters from MFA (May 4, 2012) (stating that many hedge funds managed by its members obtain further assurance that investors meet the qualification standards in the Investment Company Act or the Investment Advisers Act of 1940, as applicable, through minimum investment thresholds that meet or exceed the net worth test of the accredited investor definition); NASAA (July 3, 2012) ("For example, if an investor makes an investment of $1 million in the issuer's securities, it would be reasonable for the issuer to assume that the investor has $1 million in net worth, even though it is not necessarily a certainty. NASAA would not oppose the creation of this type of specific safe harbor, provided the factors used to demonstrate the requisite net worth are set sufficiently high."); SecondMarket (recommending that a "substantial minimum investment requirement," coupled with representations by the purchaser, should be deemed sufficient evidence to presume that a purchaser satisfies the net worth test without requiring additional verification of that purchaser's accredited investor status). One commentator, however, disagreed with this approach, noting that "[w]hile a large investment amount may indicate that the investor is wealthy, it also might indicate that a non-wealthy investor is over-concentrated in the investment." Letter from Massachusetts Securities Division.

that a person qualifies as an accredited investor, the issuer would have to take fewer steps to verify accredited investor status, and vice versa. For example, if an issuer knows little about the potential purchaser who seeks to qualify under the natural person tests for accredited investor status, but the terms of the offering require a high minimum investment amount, then it may be reasonable for the issuer to take no steps to verify accredited investor status other than to confirm that the purchaser's cash investment is not being financed by the issuer or by a third party, absent any facts that may indicate that the purchaser is not an accredited investor.

Regardless of the particular steps taken, it would be important for issuers to retain adequate records that document the steps taken to verify that a purchaser was an accredited investor. Any issuer claiming an exemption from the registration requirements of Section 5 has the burden of showing that it is entitled to that exemption.[55]

We are mindful of the differing views expressed by commentators to date on how the Commission should implement the verification mandate of Section 201(a). A number of commentators have cautioned that unduly prescriptive or burdensome rules for verifying a purchaser's accredited investor status would have the potential to result in significant economic harm, could lead to reluctance on the part of issuers to access the relevant capital markets, or would contravene the purposes of the JOBS Act.[56] Some

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[55] SEC v. Ralston Purina, 346 U.S. 119, 126 (1953) ("Keeping in mind the broadly remedial purposes of federal securities legislation, imposition of the burden of proof on an issuer who would plead the exemption seems to us fair and reasonable.").

[56] See, e.g., letters from Committee on Securities Regulation of the New York City Bar Association ("NYC Bar Association") (stating that unduly detailed or prescriptive verification rules would "have the potential to result in significant economic harm"); SecondMarket (asserting that "[p]lacing too heavy a burden on issuers and investors could have the undesired effect of inhibiting private capital formation" and that "issuers are likely to be unwilling or unable to assume the liability and cost that would arise from a significant documentary verification requirement"); NSBA (Aug. 2, 2012) (stating that "imposing additional burdens on Rule 506 issuers who engage in general solicitation or general advertising would

commentators recommended approaches based on current practices or standards.[57] One commentator, for example, stated that whether a purchaser is an accredited investor depends on the particular facts and circumstances, that the current practices already take these considerations into account, and that the Commission should therefore refrain from imposing any additional burdens on issuers or purchasers.[58] Another commentator expressed similar views, recommending that the Commission adopt a principles-based non-exclusive safe harbor that would be flexible enough to accommodate new offering techniques and that would build on existing practices (such as broker-dealers' account-opening and suitability procedures).[59]

Other commentators stated that the verification mandate of Section 201(a) requires the Commission to enhance the current standard under which issuers determine

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make it more difficult for small firms to raise capital"); Small Biotechnology Business Coalition ("SBBC") (stating that additional burdens on issuers seeking to utilize Rule 506 would make it more difficult for small firms to raise capital, and make it less likely that investors will invest in small firms); ABA (asserting that a verification requirement that imposes additional burdens on issuers or purchasers "would contravene the fundamental impetus for the JOBS Act"); MFA (June 26, 2012) (stating that "overly restrictive procedures ... would have the effect of thwarting the purposes of Title II of the JOBS Act").

[57] See, e.g., letters from BrokerBank (noting that self-certification of accredited investor status has been the "procedure that has been followed by the industry for decades" and urging the Commission to continue to allow self-certification of accredited status of individuals wishing to participate in Rule 506 offerings that utilize general solicitation); Phillip Goldstein, Bulldog Investors ("Goldstein") (July 18, 2012) (urging that the Commission "promptly create a simple form that an issuer can provide to an investor to certify that he or she is accredited"); MFA (May 4, 2012) (stating that methods similar to those currently used by hedge fund managers, which include the identification by the purchaser of the qualification standards that it meets and minimum investment thresholds, would achieve the objectives of Section 201(a)); Securities Industry and Financial Markets Association ("SIFMA") (urging that the requirement to take reasonable steps to verify should not impose a higher burden than the "reasonable belief" standard currently applicable to Rule 506 offerings and that an issuer should be deemed to have taken reasonable steps to verify if it has reasonable belief that the offeree is an eligible offeree).

[58] Letter from ABA.

[59] Letter from NYC Bar Association. For example, in connection with complying with anti-money laundering requirements, broker-dealers already obtain certain identifying information about their customers.

that purchasers are accredited investors.[60] In their view, the verification mandate of Section 201(a) calls for a standard that is higher than the current reasonable belief standard in the Rule 501(a) definition of accredited investor and such higher standard is needed in light of the greater likelihood of fraudulent activities resulting from the removal of the prohibition against general solicitation. Therefore, these commentators believe that the Commission must mandate the specific steps that issuers must take in order to form a reasonable belief that a purchaser is an accredited investor.[61]

We also received a number of comments on specific methods that should or should not be viewed as reasonable steps for verifying accredited investor status. For example, some viewed a representation from the purchaser that it is an accredited investor as sufficient,[62] while others asserted that such a representation alone would not be enough.[63] Several commentators stated that the verification of accredited investor status should require the production of documentary evidence.[64] One commentator

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60 See letters from Fund Democracy; Moscovitz and Maxfield; NASAA (July 3, 2012); Ohio Division; Public Citizen.

61 Id.

62 Letters from Goldstein (June 3, 2012); Mona Shah & Associates; SIFMA; JC Williams II, Tucson Business Development Group ("Williams").

63 Letters from Fund Democracy (stating that a representation from the purchaser that it is an accredited investor would not satisfy the statutory mandate that the issuer take steps to verify accredited investor status); John C. Nimmer ("Nimmer"); Ohio Division ("A 'check-the-box' approach to investor self-verification of accredited status will not suffice because the Title II issuer must have more than a belief that a prospective purchaser is accredited.").

64 See letters from Massachusetts Securities Division (stating that verification should require issuers to determine whether investors are accredited based on documentary evidence, rather than just representations from potential investors); NASAA (July 3, 2012) (recommending that the Commission require issuers to obtain documents such as tax returns, recent pay stubs, brokerage statements, tax assessment valuations, appraisals, list of liabilities (including a sworn statement that all material liabilities have been disclosed), organizational documents, balance sheets, and quarterly statements); Ohio Division (recommending that the issuer should "review financial statements and/or tax returns evidencing actual satisfaction of accredited investor thresholds" and, with respect to entities claiming to be accredited investors, should review "regulatory letters or certificates approving or confirming the entity's status as a bank, insurance company, registered investment company, business development company, or small business investment company").

recommended that only registered broker-dealers, and not other intermediaries, be permitted to verify accredited investor status on behalf of issuers because registered broker-dealers are subject to existing regulatory schemes, including Commission oversight.[65] Other commentators recommended allowing issuers to rely on third-party firms to verify accredited investor status.[66] Some commentators suggested that purchasers be required to submit a letter from a third party with knowledge of the purchaser's financial status (such as a certified public accountant or attorney) indicating that the purchaser is an accredited investor,[67] while another commentator suggested that, in combination with an independent professional's certification as to the purchaser's accredited investor status, the purchaser be required to certify his or her accredited investor status under penalty of perjury.[68] Another commentator stated that issuers should be allowed to rely on basic information about a purchaser that they may already have (for example, that the purchaser is an officer of a Fortune 500 company).[69] One

[65] Letter from SecondMarket (also suggesting that the Commission establish specific guidelines that registered broker-dealers must follow with respect to the verification process in order to be an approved "accreditation verification provider").

[66] See letters from National Investment Banking Association ("NIBA") (recommending that if a FINRA member firm is not involved in the offering, then the issuer could satisfy the verification mandate by relying on a third-party report obtained from an investigatory firm indicating that a purchaser is an accredited investor; if a broker-dealer is involved in the offering as a placement agent, the issuer could satisfy the verification mandate by obtaining and reviewing a form from the broker-dealer that describes the process undertaken by the broker-dealer to establish accredited investor status for a purchaser); NSBA (Aug. 2, 2012) (stating that "[r]equiring investors to provide to issuers an independent professional's certification as to the investor's accredited investor status and requiring the investor to certify his or her own status under penalty of perjury would provide a high degree of protection against non-accredited investors asserting accredited investor status in Regulation D offerings"); Sigelman Law Corporation (asserting that third-party verification of accredited investor status should not be limited to broker-dealers but that independent third-party professional intermediaries "registered with the Commission and sworn to follow the protocol rules" should be allowed to provide such services).

[67] See letters from Frank Nagy; Williams.

[68] Letter from NSBA (Aug. 2, 2012) (stating that Section 1746 of Title 28 of the United States Code authorizes this approach). One commentator stated that self-certification under penalty of perjury, in and of itself, should be sufficient. Letter from Nimmer.

[69] Letter from AngelList.

commentator suggested that the Commission adopt an approach under which a minimum investment of 50% of the net worth or total assets requirement under the applicable category of accredited investor, coupled with a certification by the investor, would be deemed to constitute "reasonable steps" to verify accredited investor status.[70] Another commentator suggested that investors be permitted to self-certify their accredited investor status so long as at least 30 days have passed between the first date of public solicitation and the date of investment.[71]

We believe that the approach we are proposing appropriately addresses these concerns by obligating issuers to take reasonable steps to verify that the purchasers are accredited investors, as mandated by Section 201(a), but not requiring them to follow uniform verification methods that may be ill-suited or unnecessary to a particular offering or purchaser, given the facts and circumstances. We also expect that such an approach would give issuers and market participants the flexibility to adopt different approaches to verification depending on the circumstances, to adapt to changing market practices, and to implement innovative approaches to meeting the verification requirement, such as the development of third-party databases of accredited investors. In addition, we anticipate that many practices currently used by issuers in connection with existing Rule 506 offerings would satisfy the verification requirement proposed for offerings pursuant to Rule 506(c).

We considered but have decided not to propose requiring issuers to use specified methods of verification. We believe that, at present, proposing to require issuers to use

[70] Letter from MFA (June 26, 2012).

[71] Letter from SBBC (noting that such a "cooling off" period will help discourage impulse investments and will permit the issuer and the investor to assess one another).

specified methods of verification would be impractical and potentially ineffective in light of the numerous ways in which a purchaser can qualify as an accredited investor, as well as the potentially wide range of verification issues that may arise, depending on the nature of the purchaser and the facts and circumstances of a particular Rule 506(c) offering. We are also concerned that a prescriptive rule that specifies required verification methods could be overly burdensome in some cases, by requiring issuers to follow the same steps, regardless of their particular circumstances, and ineffective in others, by requiring steps that, in the particular circumstances, would not actually verify accredited investor status.

For similar reasons, we considered but have decided not to propose providing a non-exclusive list of specified methods for satisfying the verification requirement.[72] We are concerned that, in designating such a list – for example, by setting forth particular types of information that issuers may rely upon as conclusive means of verifying accredited investor status – there may be circumstances where such information would not actually verify accredited investor status or where issuers may unreasonably overlook or disregard other information indicating that a purchaser is not, in fact, an accredited investor. Indeed, a method that is reasonable under one set of circumstances may not be reasonable under a different set of circumstances. In addition, we are concerned that a non-exclusive list of specified verification methods could be viewed by market participants as the required verification methods, in which compliance with at least one of

[72] See letters from MFA (June 26, 2012) (suggesting that the Commission publish a non-exclusive list of the types of third-party evidence that an investor could provide to establish accredited investor status, in conjunction with certifying that he or she is an accredited investor); NASAA (July 3, 2012) (recommending that the Commission set forth non-exclusive safe harbors to specify the types of actions that would be deemed "reasonable steps to verify" for three types of accredited investors: natural persons who purport to satisfy the income test; natural persons who purport to satisfy the net worth test; and entities who purport to meet one of the other tests set forth in Rule 501(a)).

the enumerated methods could be viewed, in the practical application of the verification requirement, as necessary in all circumstances to demonstrate that the verification requirement has been satisfied, thereby eliminating the flexibility that proposed Rule 506(c) is intended to provide. Such flexibility is likely to mitigate the cost to issuers of complying with proposed Rule 506(c) because it would allow them to select the most cost-effective verification method for each offering, based on the particular facts and circumstances of the offering and of the investors.

We are soliciting comment on a variety of possible approaches to verification. In addition, following the completion of this rulemaking, we intend to monitor and study the development of verification practices by issuers, securities intermediaries and others as well as the impact of compliance with this requirement on investor protection and capital formation.

### C. Reasonable Belief that All Purchasers Are Accredited Investors

A number of commentators have raised concerns that the language of Section 201(a) could be interpreted as precluding the use of the "reasonable belief" standard in Rule 501(a) in determining whether a purchaser is an accredited investor, such that an issuer's determination as to whether a purchaser is an accredited investor is subject to an absolute, rather than a "reasonable belief," standard.[73] Section 201(a)(2) of the JOBS Act, which calls for amendments to Rule 144A, specifically refers to a "reasonable belief" standard as to whether a purchaser is a QIB, whereas Section 201(a)(1) does not mention a similar "reasonable belief" standard with respect to the amendments to Rule

[73] See, e.g., letters from ABA; BlackRock, Inc. ("BlackRock"); NYC Bar Association; William K. Sjostrom, Jr.

506.[74] From this, some commentators have requested that our proposed rule amendments "confirm" that the reasonable belief standard for accredited investor status in Rule 501(a) continues to apply.[75] In their view, issuers may be more reluctant to use general solicitation in Rule 506 offerings if their determinations as to whether a purchaser is an accredited investor are subject to an absolute standard. One commentator added that the Commission should adopt a safe harbor under which an issuer or broker-dealer would not be penalized if it took the steps required by the Commission to verify a purchaser's accredited investor status, but later learned that the purchaser was not, in fact, an accredited investor.[76] Other commentators have interpreted this omission as indicating Congress's intent that the Commission "raise the 'reasonable belief' standard for Rule 506 offerings…."[77]

Both Rule 506 and Rule 144A currently provide for a reasonable belief standard regarding the eligibility of an investor to participate in an offering under the respective rules, but they reach that result in different ways. For Rule 506, the Commission chose to include the reasonable belief standard within the Rule 501(a) definition of "accredited investor"; for Rule 144A, the Commission chose to include the standard as a condition, in paragraph (d)(1), to the use of the exemption.[78] The definition of accredited investor

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[74] See, e.g., letters from ABA; Fund Democracy; NYC Bar Association.

[75] See, e.g., letter from ABA.

[76] Letter from NIBA. To facilitate third-party verification of accredited investor status, another commentator requested clarification that a third party providing verification services for issuers would not incur any liability as long as it had a reasonable belief that a purchaser was an accredited investor, based on its knowledge of the investor. Letter from AngelList.

[77] Letter from Fund Democracy. See also letter from Massachusetts Securities Division.

[78] Regulation S also has a reasonable belief standard with respect to the requirement that the offer or sale be made to a person outside the United States. See Rule 902(h)(1)(ii)(A) [17 CFR 230.902(h)(1)(ii)(A)] ("At the time the buy order is originated, the buyer is outside the United States, or the seller and any person acting on its behalf reasonably believe that the buyer is outside the United States.").

remains unchanged with the enactment of the JOBS Act and includes persons that come within any of the listed categories of accredited investors, as well as persons that the issuer reasonably believes come within any such category. In our view, the difference in the language between Section 201(a)(1) and Section 201(a)(2) reflects only the differing manner in which the reasonable belief standard was included in the respective rules at the time they were adopted, and does not represent a Congressional intent to eliminate the existing reasonable belief standard in Rule 501(a) or for Rule 506 offerings.

We recognize that a person could provide false information or documentation to an issuer in order to purchase securities in an offering made under proposed Rule 506(c). Thus, even if an issuer has taken reasonable steps to verify that a purchaser is an accredited investor, it is possible that a person nevertheless could circumvent those measures.[79] If a person who does not meet the criteria for any category of accredited investor purchases securities in a Rule 506(c) offering, we believe that the issuer would not lose the ability to rely on the proposed Rule 506(c) exemption for that offering, so long as the issuer took reasonable steps to verify that the purchaser was an accredited investor and had a reasonable belief that such purchaser was an accredited investor.[80]

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[79] We note that several federal courts have been unsympathetic to attempts by investors who represented that they were accredited investors at the time of the sale of securities to subsequently disavow those representations in order to pursue a cause of action under the federal securities laws. See, e.g., Wright v. Nat'l Warranty Co., 953 F.2d 256 (6th Cir. 1991) (rejecting the plaintiffs' argument that Rule 505 was unavailable because the plaintiffs "specifically warranted and represented in the subscription agreement … that they were accredited investors"); Goodwin Properties, LLC v. Acadia Group, Inc., 2001 U.S. Dist. LEXIS 9975 (D. Me. 2001) (noting that the plaintiffs "provided the defendants with reason to believe that they were accredited investors as defined by 17 C.F.R. § 230.501(a)" and stating that therefore "[t]hey cannot now disavow those representations in order to support their claims against the defendants"); Faye L. Roth Revocable Trust v. UBS Painewebber Inc., 323 F. Supp. 2d 1279 (S.D. Fla. 2004) (stating that the plaintiffs "cannot disavow their representations that they were accredited investors" and concluding that there was no material dispute that the offering complied with Regulation D).

[80] Our views regarding an issuer's ability to maintain the exemption for a proposed Rule 506(c) offering notwithstanding the fact that not all purchasers are accredited investors are consistent with our views regarding the effect of attempts by prospective investors to circumvent the requirement in Regulation S that

## D. Form D Check Box for Rule 506(c) Offerings

Form D is the notice of an offering of securities made without registration under the Securities Act in reliance on an exemption provided by Regulation D.[81] Under Rule 503 of Regulation D, an issuer offering or selling securities in reliance on Rule 504, 505 or 506 must file a notice of sales on Form D with the Commission for each new offering of securities no later than 15 calendar days after the first sale of securities in the offering. Form D is currently organized around 16 numbered "items" or categories of information. The information required to be provided in a Form D filing includes basic identifying information, such as the name of the issuer of the securities and the issuer's year and place of incorporation or organization; information about related persons (executive officers, directors, and promoters); identification of the exemption or exemptions being claimed for the offering; and factual information about the offering, such as the duration of the offering, the type of securities offered, and the total offering amount.

We are proposing a revision to Form D to add a separate field or check box for issuers to indicate whether they are claiming an exemption under Rule 506(c). Item 6 of Form D currently requires the issuer to identify the claimed exemption or exemptions for the offering from among Rule 504's paragraphs and subparagraphs, Rule 505, Rule 506 and Section 4(5), as applicable. A new check box in Item 6 of Form D would require issuers to indicate specifically whether they are relying on the proposed Rule 506(c)

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offers and sales be made only to non-U.S. persons. See Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore, Release No. 33-7516 (Mar. 23, 1998) [63 FR 14806] ("In our view, if a U.S. person purchases securities or investment services notwithstanding adequate procedures reasonably designed to prevent the purchase, we would not view the Internet offer after the fact as having been targeted at the United States, absent indications that would put the issuer on notice that the purchaser was a U.S. person.").

[81] Form D also applies to offerings conducted using the Section 4(a)(5) exemption. The Commission adopted Form D when it adopted Regulation D in 1982. Release No. 33-6389 (adopting Form D as a replacement for Forms 4(6), 146, 240 and 242).

exemption. In addition, the current check box for "Rule 506" would be renamed "Rule 506(b)," and the current check box for "Section 4(5)" would be renamed "Section 4(a)(5)" to update the reference to former Section 4(5) of the Securities Act.

We are proposing to require this additional information in order to assist our efforts to monitor the use of general solicitation in Rule 506(c) offerings and the size of this offering market. This information would also help us to look into the practices that would develop to satisfy the verification requirement, which would help us assess the effectiveness of various verification practices in identifying and excluding non-accredited investors from participation in proposed Rule 506(c) offerings.

### E. Specific Issues for Privately Offered Funds

Privately offered funds, such as hedge funds, venture capital funds and private equity funds, typically rely on Section 4(a)(2) and the Rule 506 safe harbor to offer and sell their interests without registration under the Securities Act.[82] In addition, privately offered funds generally rely on one of two exclusions from the definition of "investment company" under the Investment Company Act, which enables them to be excluded from the regulatory provisions of that Act. Privately offered funds are precluded from relying on either of the two exclusions set forth in Section 3(c)(1)[83] and Section 3(c)(7)[84] of the Investment Company Act if they make a public offering of their securities.[85] Section

[82] See, e.g., Implications of the Growth of Hedge Funds, Staff Report to the Securities and Exchange Commission (Sept. 2003), available at: http://www.sec.gov/news/studies/hedgefunds0903.pdf.

[83] 15 U.S.C. 80a-3(c)(1).

[84] 15 U.S.C. 80a-3(c)(7).

[85] See also Section 202(a)(29) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-2(a)(29)] (defining a "private fund" as an issuer that would be an investment company under the Investment Company Act, but for Sections 3(c)(1) and 3(c)(7) of that Act). Many issuers of asset-backed securities ("ABS") also rely on the exclusions contained in Sections 3(c)(1) and 3(c)(7) of the Investment Company Act. These ABS issuers frequently participate in Rule 144A offerings.

3(c)(1) excludes from the definition of "investment company" any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 beneficial owners,[86] and which is not making and does not presently propose to make a public offering of its securities. Section 3(c)(7) excludes from the definition of "investment company" any issuer whose outstanding securities are owned exclusively by persons who, at the time of acquisition of such securities, are "qualified purchasers,"[87] and which is not making and does not at that time propose to make a public offering of its securities.

The JOBS Act directs the Commission to eliminate the prohibition against general solicitation for a new subset of Rule 506 offerings, and makes no specific reference to privately offered funds. Section 201(b) of the JOBS Act also provides that "[o]ffers and sales exempt under [Rule 506, as revised pursuant to Section 201(a)] shall not be deemed public offerings under the Federal securities laws as a result of general advertising or general solicitation." We historically have regarded Rule 506 transactions as non-public offerings for purposes of Sections 3(c)(1) and 3(c)(7).[88] We believe the effect of Section 201(b) is to permit privately offered funds to make a general solicitation under amended Rule 506 without losing either of the exclusions under the Investment Company Act.

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[86] See also Rule 3c-5 under the Investment Company Act [17 CFR 270.3c-5] (providing that the section's limit of 100 beneficial owners does not include "knowledgeable employees," as defined in the rule).

[87] See Section 2(a)(51) of the Investment Company Act [15 U.S.C. 80a-2(a)(51)] and the rules thereunder. See also Rule 3c-5 under the Investment Company Act (excluding "knowledgeable employees" from the determination of whether all of the outstanding securities of the Section 3(c)(7) fund are owned exclusively by qualified purchasers).

[88] See Release No. 33-6389 (noting that the "Commission regards rule 506 transactions as non-public offerings for purposes of the definition of 'investment company' in section 3(c)(1) of the Investment Company Act"); Privately Offered Investment Companies, Release No. IC-22597 (Apr. 3, 1997) [62 FR 17512], at n.5 (noting that the "Commission believes that section 3(c)(7)'s public offering limitation should be interpreted in the same manner as the limitation in section 3(c)(1)").

### F. Technical and Conforming Amendments

We are proposing a number of technical and conforming amendments to Rules 502 and 506 of Regulation D. We are proposing amendments to various provisions in Rule 502(b) to clarify that the references to sales to non-accredited investors under Rule 506, and the corresponding informational requirements, would be applicable to offerings under Rule 506(b) and not to offerings under proposed Rule 506(c). We are also proposing an amendment to Rule 502(c) to clarify that Rule 502(c)'s prohibition against general solicitation would not apply to offerings under proposed Rule 506(c).

As Section 201(c) of the JOBS Act renumbered Section 4 of the Securities Act, we are also proposing amendments to Regulation D and Rule 144A to update the references to Section 4. We are also proposing to update references to Section 2 of the Securities Act in these rules as some of the references have not been updated to reflect the current numbering scheme in Section 2.

### G. Request for Comment

1. Will the Commission's proposed approach to implementing the verification mandate of Section 201(a) be effective in limiting issuers' sales to only accredited investors in Rule 506 offerings that use general solicitation? Should the Commission adopt a rule that specifies the methods that issuers must use or could use to verify accredited investor status? Would such an approach provide greater certainty for issuers than the approach that we are proposing? Would the inclusion of a specified list result in an assumption or practice that the listed methods are "de facto" requirements, thereby inappropriately reducing flexibility and effectiveness of the new rule? What are the benefits and costs of each

approach? In the case of the latter, if the Commission were to adopt such a rule, should it be in the form of a safe harbor for compliance with the verification requirement? What would be examples of the types of methods that issuers could use to verify accredited investor status, and what would be the merits of each such method?

2. Some commentators have recommended that the Commission look to current market practices in determining the methods that should be required or permitted for verifying accredited investor status. As noted above, we anticipate that many practices currently used by issuers in connection with existing Rule 506 offerings would satisfy the verification requirement proposed for offerings pursuant to Rule 506(c). How effective have these practices been in assessing the eligibility of purchasers to participate in an offering made under Regulation D? Are certain practices more effective than others? If so, please describe these practices with specificity. What are the costs and benefits of these practices (to issuers, investors and other market participants)?

3. Under what circumstances, if any, should an issuer be deemed to have taken "reasonable steps to verify" if the only action taken by the issuer is to request a representation from a purchaser that it is an accredited investor, as some have suggested?[89] Should the Commission provide that an issuer is deemed to have taken "reasonable steps to verify" if the issuer "reasonably believes" that such a purchaser is an accredited investor, as some have suggested?[90] What are the

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[89] See, e.g., letter from SIFMA.

[90] See id.

potential benefits and potential harms of such an approach?

4. As we noted above, depending on the facts and circumstances, we believe there is merit to the view that the ability of a purchaser to satisfy the high minimum investment amount required to participate in an offering may be a relevant factor in determining whether that purchaser is an accredited investor. At the same time, we also believe that issuers must be mindful of any indications that the purchaser, despite the ability to provide the funds needed to satisfy a high minimum investment amount requirement, may not actually be an accredited investor. We have noted that the financing of a purchaser's cash investment by the issuer or a third party is a factor that an issuer should consider. Are there other factors? In light of these considerations, should the Commission specifically provide that a high minimum investment amount is sufficient, in and of itself, to satisfy the requirement that the issuer has taken reasonable steps to verify a purchaser's accredited investor status, provided that the high minimum investment amount is not being financed by the issuer or any third party? If so, should the rule specify an amount, and, if so, what amount would be appropriate?

5. Are there certain types of issuers (e.g., shell companies, blank check companies or issuers of penny stock, as defined by Exchange Act Rule 3a51-1[91]) that would present heightened investor protection concerns as a result of the removal of the prohibition against general solicitation? If so, what actions should the Commission take to address these concerns? Should these issuers be subject to a different verification standard for offerings made under proposed Rule 506(c)?

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[91] 17 CFR 240.3a51-1.

6. Verification methods could include obtaining information from prospective purchasers, such as Forms W-2, personal bank and brokerage account statements and similar documentation. We are cognizant that prospective purchasers may have privacy concerns when undergoing a verification process by issuers.[92] Do any other concerns in addition to privacy concerns arise from a requirement to provide such information? How, if at all, could the Commission address these concerns?[93] What other documentation could be used to verify accredited investor status while minimizing privacy concerns? Does use of a reasonably reliable third party to provide this information respond to those concerns?

7. Currently, Rule 508 of Regulation D[94] provides that the exemption in Rule 506 will not be lost due to an "insignificant" deviation from a term, condition, or requirement of Regulation D. Should Rule 508 be amended to include any additional provisions specifically related to proposed Rule 506(c)?

8. Should the Commission amend Form D to include a check box for issuers to indicate whether they are claiming an exemption under Rule 506(c), as proposed? If not, why not?

9. Are there any other rule amendments necessary or appropriate to implement the statutory mandate of Section 201(a) of the JOBS Act? Are there any other measures that the Commission should consider taking in connection with the removal of the prohibition against general solicitation?

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92 See, e.g., letter from ABA.

93 See, e.g., letter from NASAA (July 3, 2012) (recommending that the Commission require issuers to maintain the confidentiality of any information received for the purpose of verifying accredited investors status).

94 17 CFR 230.508.

## III. PROPOSED AMENDMENT TO RULE 144A

### A. Offers to Persons Other Than Qualified Institutional Buyers

Section 201(a)(2) of the JOBS Act directs the Commission to revise Rule 144A(d)(1) under the Securities Act to provide that securities sold pursuant to Rule 144A may be offered to persons other than QIBs, including by means of general solicitation, provided that securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe is a QIB. In the amendment to Rule 144A that we are proposing, we would amend Rule 144A(d)(1) to eliminate the references to "offer" and "offeree." As amended, the rule would require only that the securities are sold to a QIB or to a purchaser that the seller and any person acting on behalf of the seller reasonably believe is a QIB.[95] Under this proposed amendment, resales of securities pursuant to Rule 144A could be conducted using general solicitation, so long as the purchasers are limited in this manner.

### B. Request for Comment

10. Rule 144A currently provides a list of non-exclusive methods of establishing a prospective purchaser's ownership and discretionary investments of securities for purposes of determining whether the prospective purchaser is a QIB.[96] How has this non-exclusive list worked in practice? Do issuers favor a non-exclusive list? Why or why not? Has the non-exclusive list resulted in an assumption or practice that the listed methods are "de facto" requirements?

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[95] Proposed Rule 144A(d)(1).

[96] Rule 144A(d)(1).

## IV. INTEGRATION WITH OFFSHORE OFFERINGS

Regulation S provides a safe harbor for offers and sales of securities outside the United States and includes an issuer and a resale safe harbor. Two general conditions apply to both safe harbors: (1) the securities must be sold in an offshore transaction and (2) there can be no directed selling efforts[97] in the United States.[98] The safe harbors are important when U.S. and foreign companies engage in global offerings of securities in which the U.S. portion of the offering is conducted in accordance with Rule 144A or Rule 506 and the offshore portion is conducted in reliance on Regulation S.

The mandate in Section 201(a) that the Commission amend Rule 506 and Rule 144A to permit the use of general solicitation in transactions under those rules has raised questions from some commentators regarding the impact of the use of general solicitation on the availability of the Regulation S safe harbors for concurrent unregistered offerings inside and outside the United States.[99] One commentator recommended that the Commission reexamine the directed selling efforts concept in light of the terms and policy objectives of Section 201 of the JOBS Act, as well as evolving technology and offering techniques.[100] Another recommended that, although the JOBS Act does not explicitly address Section 4(a)(2) or the definition of directed selling efforts in Regulation S, there is no policy reason for distinguishing between the various exemptions and

[97] Rule 902(c)(1) [17 CFR 230.902(c)(1)] broadly defines "directed selling efforts" as: any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the United States for any of the securities offered in reliance on Regulation S. Such activity includes placing an advertisement in a publication "with a general circulation in the United States" that refers to the offering of securities being made in reliance upon Regulation S.

[98] See Rules 903 [17 CFR 230.903] and 904 [17 CFR 230.904] under the Securities Act.

[99] See, e.g., letters from ABA; Lee D. Neumann ("Neumann"); NYC Bar Association; SecuritiesLawUSA, PC ("SecuritiesLawUSA"); SIFMA.

[100] Letter from NYC Bar Association.

maintaining a prohibition against general solicitation in some but not others.[101] We also received requests that the Commission confirm that the use of general solicitation in offerings conducted pursuant to Rule 506 or Rule 144A, as amended, would not be deemed to constitute directed selling efforts by that issuer in connection with a contemporaneous offering under Regulation S.[102] One commentator asked for clarification that the limitations in Securities Act Rule 135c[103] do not apply to offerings pursuant to Rule 506 or Rule 144A where general solicitation is permitted,[104] while another commentator suggested that the information on Regulation S offerings that is permitted to be communicated in the United States continue to be limited to the information permitted under Rule 135c, but regardless of whether the issuer meets the eligibility criteria in Rule 135c.[105]

In the adopting release for Regulation S, the Commission stated that "[o]ffshore transactions made in compliance with Regulation S will not be integrated with registered domestic offerings or domestic offerings that satisfy the requirements for an exemption from registration under the Securities Act."[106] We believe that this approach continues to apply. Consistent with the historical treatment of concurrent Regulation S and Rule

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[101] Letter from SIFMA.

[102] Letters from ABA; SecuritiesLawUSA.

[103] 17 CFR 230.135c.

[104] Letter from SecuritiesLawUSA.

[105] Letter from Neumann.

[106] See Offshore Offers and Sales, Release 33-6863 (Apr. 24, 1990) [55 FR 18306], at Section III.C.1. In addressing the offshore transaction component of the Regulation S safe harbor, the Commission stated, "Offers made in the United States in connection with contemporaneous registered offerings or offerings exempt from registration will not preclude reliance on the safe harbors." Id. at fn. 36. Likewise, in addressing directed selling efforts, the Commission stated, "Offering activities in contemporaneous registered offerings or offerings exempt from registration will not preclude reliance on the safe harbors." Id. at fn. 47. See also Rule 500(g) of Regulation D [17 CFR 230.500(g)] (formerly Preliminary Note No. 7 to Regulation D) ("Regulation S may be relied upon for such offers and sales even if coincident offers and sales are made in accordance with Regulation D inside the United States.").

144A/Rule 506 offerings, concurrent offshore offerings that are conducted in compliance with Regulation S would not be integrated with domestic unregistered offerings that are conducted in compliance with Rule 506 or Rule 144A, as proposed to be amended.

## V. GENERAL REQUEST FOR COMMENT

We request and encourage any interested person to submit comments regarding the proposed rule and form amendments, specific issues discussed in this release, and other matters that may have an effect on the proposed rules. We request comment from the point of view of issuers, investors and other market participants. With regard to any comments, we note that such comments are of particular assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments. Commentators are urged to be as specific as possible.

## VI. PAPERWORK REDUCTION ACT

The proposed amendment to Form D contains a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[107] The title of this requirement is: "Form D" (OMB Control No. 3235-0076).[108] We adopted Regulation D and Form D as part of the establishment of a series of exemptions for offerings and sales of securities under the Securities Act. We are submitting this requirement to the Office of Management and Budget ("OMB") for review and approval in accordance with the PRA and its implementing regulations.[109]

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[107] 44 U.S.C. 3501 et seq.

[108] Form D was adopted pursuant to Sections 2(a)(15), 3(b), 4(a)(2), 19(a) and 19(c)(3) of the Securities Act (15 U.S.C. 77b(a)(15), 77c(b), 77d(a)(2), 77s(a) and 77s(c)(3)).

[109] 44 U.S.C. 3507(d); 5 CFR 1320.11.

The information collection requirements related to the filing of Form D with the Commission are mandatory to the extent that an issuer elects to make an offering of securities in reliance on the relevant exemption. Responses are not confidential. The hours and costs associated with preparing and filing forms and retaining records constitute reporting and cost burdens imposed by the collection of information requirements. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information requirement unless it displays a currently valid OMB control number.

The Form D filing is required to be made by issuers as a notice of sales without registration under the Securities Act based on a claim of exemption under Regulation D or Section 4(a)(5) of the Securities Act. The Form D is required to include basic information about the issuer, certain related persons, and the offering. This information is needed for implementing the exemptions and monitoring their use.

We are proposing to amend Form D to add a check box to indicate an offering relying on the Rule 506(c) exemption. We believe this proposed change would have a negligible effect on the paperwork burden of the form. Accordingly, we estimate that under the proposed amendment to Form D, the burden for responding to the collection of information in Form D would be substantially the same as before the proposed amendment to Form D because the additional information required in the form is minimal. However, we believe that the proposed amendment to Rule 506 would increase the number of Form D filings that are made with the Commission.

The table below shows the current total annual compliance burden, in hours and in costs, of the collection of information pursuant to Form D. For purposes of the PRA, we estimate that, over a three-year period, the average burden estimate will be 4 hours per Form D. Our burden estimate represents the average burden for all issuers. This burden is reflected as a one hour burden of preparation on the company and a cost of $1,200 per filing. In deriving these estimates, we assume that 25% of the burden of preparation is carried by the issuer internally and that 75% of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of $400 per hour. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours.

**Table 1. Estimated paperwork burden under Form D, pre-amendment to Rule 506**

| | Number of responses (A)[110] | Burden hours/form (B) | Total burden hours (C)=(A)*(B) | Internal issuer time (D) | External professional time (E) | Professional costs (F)=(E)*$400 |
|---|---|---|---|---|---|---|
| Form D | 25,000 | 4 | 100,000 | 25,000 | 75,000 | $30,000,000 |

According to our Division of Risk, Strategy, and Financial Innovation, in 2011, 15,930 companies made 18,174 new Form D filings. The annual number of new Form D filings rose from 13,764 in 2009 to 18,174 in 2011, an average increase of approximately 2,205 Form D filings per year, or approximately 15%. Assuming the number of Form D filings continues to increase by 2,205 filings per year for each of the next three years, the average number of Form D filings in each of the next three years would be approximately 22,584.

We estimate that the proposed amendment to Rule 506 would result in an even greater annual increase in the number of Form D filings. As a reference point, we use the

[110] The information in this column is based on the number of responses for Form D as reported in the OMB's Inventory of Currently Approved Information Collections, available at http://www.reginfo.gov/public/do/PRAMain;jsessionid=D37174B5F6F9148DB767D63DF6983A65.

impact of a past rule change on the market for Regulation D offerings. In 1997, the Commission amended Rule 144(d) under the Securities Act[111] to reduce the holding period for restricted securities from two years to one year,[112] thereby increasing the attractiveness of Regulation D offerings to investors and to issuers. There were 10,341 Form D filings in 1996. This was followed by a 20% increase in the number of Form D filings in each of the subsequent three calendar years, reaching 17,830 by 1999. Although it is not possible to predict with any degree of accuracy the increase in the number of Rule 506 offerings following the elimination of the prohibition against general solicitation, we anticipate that there would be a similarly significant increase. For purposes of the PRA, we estimate that the proposed amendment to Rule 506 would result in a 20% increase in Form D filings relying on the Rule 506 exemption, or approximately 5,000 filings, based on the number of responses as reported in the OMB's Inventory of Currently Approved Information Collections.[113] We also assume that the number of Form D filings would increase by approximately 5,000 in each year following the adoption of the rule.

Based on this increase, we estimate that the annual compliance burden of the collection of information requirements for issuers making Form D filings after Rule 506 is amended to eliminate the prohibition against general solicitation would be an aggregate 30,000 hours of issuer personnel time and $36,000,000 for the services of outside professionals per year.

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[111] 17 CFR 230.144(d).

[112] See Revision of Holding Period Requirements in Rules 144 and 145, Release No. 33-7390 (Feb. 20, 1997) [62 FR 9242].

[113] Based on the 18,174 new Form D filings that were actually made in 2011, the annual increase would be 3,635 filings.

**Table 2.** **Estimated paperwork burden under Form D, post-amendment to Rule 506**

| | Number of responses (A)[114] | Burden hours/form (B) | Total burden hours (C)=(A)*(B) | Internal issuer time (D) | External professional time (E) | Professional costs (F)=(E)*$400 |
|---|---|---|---|---|---|---|
| Form D | 30,000 | 4 | 120,000 | 30,000 | 90,000 | $36,000,000 |

We request comment on the accuracy of our estimates. Pursuant to 44 U.S.C. 3506(c)(2)(A), the Commission solicits comments to: (1) evaluate whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of burden of the collection of information; (3) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of the collection of information on those who are required to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-07-12. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in

[114] The information in this column is based on the 25,000 filings reported in the OMB's Inventory of Currently Approved Information Collections, plus the additional 5,000 filings we estimate would be filed as result of proposed Rule 506(c).

writing, refer to File No. S7-07-12, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-1090. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is assured of having its full effect if OMB receives it within 30 days of publication.

## VII. ECONOMIC ANALYSIS

### A. Background and Summary of Proposed Rule and Form Amendments

We are proposing amendments to Rule 506 and Rule 144A to implement the requirements of Section 201(a) of the JOBS Act. Section 201(a)(1) directs the Commission to revise Rule 506 to provide that the prohibition against general solicitation contained in Rule 502(c) shall not apply to offers and sales of securities made pursuant to Rule 506, as amended, provided that all purchasers of the securities are accredited investors. Section 201(a)(1) also provides that "such rules shall require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission." Section 201(a)(2) of the JOBS Act directs the Commission to revise Rule 144A(d)(1) to provide that securities sold pursuant to Rule 144A may be offered to persons other than QIBs, including by means of general solicitation, provided that securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs.

We are mindful of the costs imposed by and the benefits obtained from our rules. The discussion below attempts to address the economic effects of the proposed amendments, including the likely costs and benefits of the amendments as well as the effect of the amendments on efficiency, competition and capital formation.[115] Some of the costs and benefits stem from the statutory mandate of Section 201(a), while others are affected by the discretion we exercise in implementing this mandate. These two types of costs and benefits may not be entirely separable to the extent our discretion is exercised to realize the benefits that we believe were intended by Section 201(a). We request comment on all aspects of the economic effects, such as the costs and benefits, of the amendments that we are proposing. We particularly appreciate comments that distinguish between the economic effects that are attributed to the statutory mandate itself and the economic effects that are the result of policy choices made by the Commission in implementing the statutory mandate.

### B. Baseline

The baseline for our economic analysis is the market for Rule 506 offerings and the market for Rule 144A offerings, as they exist today.

The Regulation D market is large compared to other markets, and offerings claiming the Rule 506 exemption are by far the dominant type of offering in the Regulation D market. In 2011, 2010 and 2009, issuers raised an estimated \$895 billion, \$902 billion and \$581 billion, respectively, in transactions claiming the Rule 506 exemption.[116] These amounts represent approximately 99% of the capital reported as raised under Regulation D during this period and approximately 93% of the number of

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[115] Section 2(b) of the Securities Act requires the Commission, when engaging in rulemaking that requires it to consider whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. 15 U.S.C. 77b(b).

[116] The statistics in this section are based on a review of Form D electronic filings with the Commission – specifically, the "total amount sold" as reported in Form D – and data regarding other types of offerings (e.g., public debt offerings and Rule 144A offerings) from Securities Data Corporation's New Issues database (Thomson Financial). See note 25, supra.

Regulation D offerings during this period. In 2011 and 2010, the estimated amounts raised in Regulation D offerings exceeded the amounts raised in all other private offerings (Rule 144A offerings, Regulation S offerings, and other Section 4(a)(2) offerings), public debt and public equity offerings, combined. In 2009, the estimated amounts raised in Regulation D offerings were second only to the amounts raised in public debt offerings.

The Rule 144A market is also an important market for raising capital. In 2011 and 2010, the estimated amount of capital (including both equity and debt securities) raised in Rule 144A offerings was $168 billion and $233 billion, compared to $984 billion and $1.07 trillion, respectively, raised in registered offerings.

### C. Eliminating the Prohibition Against General Solicitation in Rule 506 Offerings and Rule 144A Offerings

The elimination of the prohibition against general solicitation for a subset of Rule 506 offerings would likely have a number of effects on issuers and investors. When using general solicitation, issuers would be able to reach a greater number of potential investors, thus increasing their access to capital. The proposed amendment to Rule 506 would likely reduce search costs associated with finding accredited investors who may be interested in a particular private offering, thus enhancing efficiency. The increase in the number of potential investors could result in greater competition among investors interested in investing in an issuer, which may result in a lower cost of capital for issuers. We expect these benefits to issuers to generally be lower for Rule 144A offerings because QIBs, who are the investors in Rule 144A offerings, are generally fewer in number, known by market participants, and better networked than accredited investors. Thus, the elimination of the prohibition against general solicitation for Rule 144A offerings is unlikely to dramatically increase issuers' access to QIBs in such offerings or to have a meaningful effect on the cost of capital in Rule 144A offerings.

When using general solicitation, issuers may be able to reach investors directly, without the need of an intermediary, which could result in lower transaction costs, and perhaps a lower cost of capital, for issuers. An analysis of all Form D filings on EDGAR made during the period from 2009 to 2011 shows that approximately 11% of all new offerings reported sales commissions of greater than zero because the issuers used intermediaries.[117] The average commission paid to these intermediaries was 5.7% of the offering size, with the median commission being approximately 5%. For a $5 million offering, which was the median size of a Regulation D offering with a commission during this period, an issuer could potentially save up to $250,000 if the issuer reaches investors directly rather than through an intermediary, minus the cost of its own solicitation efforts and the cost associated with verifying accredited investor status.[118] This potential benefit would likely be larger for smaller issuers. Based on the analysis of these Form D filings as described above, issuers reporting annual revenues up to $25 million pay on average a 6.4% commission, while issuers with annual revenues over $100 million pay approximately a 3.3% commission and hedge funds and other privately offered funds pay approximately a 2.7% commission.

The elimination of the prohibition against general solicitation also would reduce the uncertainty for issuers as to whether a Rule 506 offering can be completed in certain

117 Ivanov/Bauguess Study.

118 We recognize, of course, that the involvement of an intermediary can provide benefits in addition to locating investors. For example, an intermediary may be able to help an issuer obtain better pricing and terms or provide access to investors that can provide strategic or other advice to the issuer.

situations, and would eliminate the costs of complying with the prohibition.[119] Under existing Rule 506, an inadvertent leak of information about an offering to entities or persons with whom the issuer does not have a pre-existing substantive relationship has been viewed by some as raising questions about the issuer's ability to rely on the exemption for the entire offering.[120] In addition, some privately offered funds have been reluctant to respond to press inquiries or to correct inaccurate reports due to concerns about these discussions being misconstrued as a general solicitation.[121] Under proposed Rule 506(c), any such uncertainty as to the availability of the exemption would likely be reduced, so long as issuers take reasonable steps to verify that they are selling only to accredited investors.

From the standpoint of investors, accredited investors who previously have found it difficult to identify investment opportunities in Rule 506 offerings would be able to identify, and potentially invest in, a larger and more diverse pool of potential investment opportunities. In addition, the elimination of the prohibition against general solicitation in some Rule 506 offerings would likely increase the flow of information about issuers to investors that may not have been publicly available previously, thereby potentially leading to more efficient pricing for the offered securities.[122] Thus, the proposed rule

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119 Letter from MFA (May 4, 2012).

120 See, e.g., letter from Simon M. Lorne and Joseph McLaughlin (Aug. 5, 2008) on Revisions of Limited Offering Exemptions in Regulation D, Release No. 33-8828 (Aug. 3, 2007) [72 FR 45116] ("On occasion, the prohibition forces issuers to delay or even cancel offerings because of communications – sometimes inadvertent – that could be viewed in hindsight as a solicitation. The need to police communications by transaction participants, and to analyze and remedy inadvertent communications, also adds significantly to the cost of effecting private placements.").

121 See, e.g., letters from D.E. Shaw & Co. (Apr. 3, 2006) on Exposure Draft of Final Report of Advisory Committee on Smaller Public Companies, Release No. 33-8666 (Feb. 28, 2006); MFA (May 4, 2012).

122 This may not be applicable with respect to every issuer (e.g., certain privately offered funds that offer their shares continuously at net asset value).

amendment may increase capital formation and at the same time improve its allocative efficiency.[123] With respect to privately offered funds in particular, eliminating the prohibition would allow accredited investors to gather information about privately offered funds at relatively lower costs and to allocate their capital more efficiently.[124] Increased information about privately offered fund strategies, management fees and performance information would likely lead to greater competition among privately offered funds for investor capital.

Although proposed Rule 506(c) would directly affect the private offering market, it could also have an indirect effect on other markets. The elimination of the prohibition against general solicitation for a subset of Rule 506 offerings may lower the degree of information asymmetry between Rule 506 issuers and potential investors. The lower search costs associated with finding Rule 506(c) offerings may cause some investors that currently invest in public equity and debt markets or other private offering markets to reallocate capital to the offerings made under proposed Rule 506(c). If a significant number of investors make a greater proportion of their investments in the Rule 506(c) market, such investor behavior may have a negative effect on the supply of capital and prices in the public equity and debt markets and in other non-registered offering markets. For example, issuers currently using the exemptions in Regulation A[125] and in Rule 504(b)(1)(i)-(iii) to solicit investors could prefer to rely on the exemption under proposed

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[123] Allocative efficiency is a condition that is reached when resources are allocated in a way that allows the maximum possible net benefit from their use. In this context, it means the right number of dollars from the right types of investors going to the most suitable investments on efficient terms.

[124] See, e.g., letter from MFA (May 4, 2012) and Managed Funds Association, Petition for Rulemaking on Rule 502 of Regulation D under the Securities Act of 1933, File No. 4-643 (Jan. 9, 2012).

[125] 17 CFR 230.251 through 17 CFR 230.263.

Rule 506(c) because they would be able to raise unlimited amounts of capital under proposed Rule 506(c) and state blue sky securities registration requirements would not apply to these offerings. While it is difficult to estimate how many of these issuers would choose to rely on proposed Rule 506(c) in lieu of the other available exemptions from registration, we believe that it is likely that Rule 506(c) would have a larger impact on issuers using Rule 504 rather than Regulation A, mainly because very few issuers have been using the Regulation A exemption in recent years.[126] In addition, to the extent that accredited investors have invested in registered investment companies instead of privately offered funds because of information asymmetry between privately offered funds and registered investment companies, it is possible that registered investment companies' assets may be negatively affected if these investors now transfer their assets to privately offered funds.

We believe that retaining the existing Rule 506 as Rule 506(b) would generate benefits for both issuers and investors. It would allow issuers that do not wish to generally solicit in their private offerings to avoid the added expense of complying with the rules applicable to Rule 506(c) offerings. It would also allow issuers to continue selling privately to up to 35 non-accredited investors who meet existing Rule 506's sophistication requirements. The continued availability of Rule 506(b) may also be beneficial to investors with whom the issuer has a pre-existing substantive relationship and who do not wish to bear additional verification costs that may be associated with participation in Rule 506(c) offerings.

[126] From 2009 to 2011, based on our review of Form D filings and Forms 1-A, 1,735 issuers relied on the Rule 504 exemption, and 10 issuers relied on Regulation A. The number of issuers using Regulation A to raise capital may increase once the Commission adopts rules implementing Title IV of the JOBS Act.

On the other hand, eliminating the prohibition against general solicitation could make it easier for promoters of fraudulent schemes to reach potential investors through public solicitation and other methods previously not allowed. This could result in an increase in the level of due diligence conducted by investors in assessing proposed Rule 506(c) offerings, and in the event of fraud, would likely lead to costly lawsuits for investors seeking damages. In general, an increase in fraud in this market would harm investors who are defrauded, would undermine investor confidence in Rule 506 offerings and could negatively affect capital-raising by legitimate issuers – for example, by reducing investor participation in Rule 506 offerings – thus inhibiting capital formation and reducing efficiency. Further, one commentator is concerned that investors may confuse privately offered funds with registered investment companies.[127] In such cases, fraud that occurs with privately offered funds may cause investors to associate the wrongdoing with registered investment companies, and therefore refrain from investing in registered investment companies. In addition, some issuers with publicly-traded securities may use general solicitation for a purported Rule 506 offering to generate investor interest in the secondary trading markets, especially in the over-the-counter markets, which could be used by insiders to resell securities at inflated prices. This "pump and dump" activity would impose costs to investors in these secondary markets, as well as investors in Rule 506 offerings, and could erode investor confidence in Rule 506 offerings, thus potentially raising the cost of capital for issuers in this market.

[127] See letter from ICI re: Rulemaking Petition File No. 4-463: Request by MFA for Rulemaking to Amend Rule 502(c) of Regulation D to Eliminate the Prohibition on Offers or Sales of Securities by General Solicitation or Advertising With Respect to Private Funds (Feb. 7, 2012); and letter from ICI (May 21, 2012).

The risks to investors of fraudulent offerings conducted under proposed Rule 506(c) may be mitigated to some extent by the requirement that issuers sell only to accredited investors (with reasonable steps to verify such status), who may be better able to assess their ability to take financial risks and bear the risk of loss than investors who are not accredited. In addition, issuers would still be subject to the antifraud provisions under the federal securities laws, and the public nature of these solicitations may facilitate detection of fraudulent activity.

We expect that there would be fewer occurrences of general solicitation-facilitated fraud in Rule 144A offerings, as compared to Rule 506(c) transactions. Unlike most Rule 506 transactions, Rule 144A offerings always include a financial intermediary. The due diligence conducted by these intermediaries is an additional layer of protection against fraud. Also, Rule 144A investors are generally large institutions, which are better able to identify fraudulent activities than smaller institutions and retail investors.

In regard to Rule 144A, we anticipate that eliminating the prohibition against general solicitation would significantly affect private trading systems by permitting information vendors to provide more information about Rule 144A securities. Indeed, since offers could be made to the public, the information on private trading systems for Rule 144A securities could be made available to all investors, even though sales would be limited to QIBs.[128] In addition, currently there is no public dissemination through Trade Reporting and Compliance Engine ("TRACE") of transactions in Rule 144A

[128] Under the PORTAL Trading System developed by the Nasdaq Stock Market for trading Rule 144A securities, access is restricted to QIBs. Other privately developed Rule 144A trading systems, such as Portal Alliance, have similar restrictions.

securities.[129] Once Rule 144A is amended to permit offers to be made to persons other than QIBs, FINRA may decide to amend its rules to permit public dissemination of transaction information with respect to Rule 144A securities. Such improvements in the information available to potential investors could enhance efficiency in this market.

### D. Verifying Accredited Investor Status in Rule 506(c) Offerings

The requirement in proposed Rule 506(c) for issuers to take reasonable steps to verify that purchasers are accredited investors would likely make it more difficult for those issuers whose existing practices do not already satisfy the verification requirement to sell securities to non-accredited investors, thereby lessening the likelihood that fraudulent offerings would be completed because those who are eligible to purchase are more likely to be able to protect their interests than investors who are not accredited investors. Preserving the integrity of the Rule 506 market and reducing the incidence of fraud would benefit investors by giving them greater assurance that they are investing in legitimate issuers. In turn, issuers would also benefit from measures that improve the integrity and reputation of the Rule 506 market because they would be able to attract more investors and capital. Issuers would benefit as well from the additional certainty that the Rule 506 safe harbor is available for an offering when this verification requirement is met.

Our proposal not to specify the verification methods that an issuer must use or could use in taking reasonable steps to verify accredited investor status would provide issuers with flexibility to use methods that are appropriate, given the facts and circumstances of each offering and each purchaser. Such flexibility is likely to mitigate

[129] See FINRA Rule 6750. There is mandatory reporting of over-the-counter trades in fixed income securities.

the cost to issuers of complying with proposed Rule 506(c) because it would allow them to select the most cost-effective verification method for each offering.

The verification requirement in proposed Rule 506(c) would impose costs as well. Some potential investors likely would have to provide more information to issuers than they currently provide, while some issuers may have to apply a stricter and more costly process to determine accredited investor status than what they currently use. While it is reasonable to expect that the costs associated with the verification requirement could be offset somewhat by its benefits, it is also reasonable to expect that some accredited investors who would participate in existing Rule 506(b) offerings would decline to participate in proposed Rule 506(c) offerings. Compared to an alternative that prescribes specific verification methods or provides a non-exclusive list of verification methods, the greater flexibility of the proposed verification standard could result in less rigorous verification, thus allowing some unscrupulous issuers to more easily sell securities to purchasers who are not accredited investors and perpetrate fraudulent schemes. In addition, a flexible "reasonableness" verification approach may create or promote legal uncertainty about the availability of the exemption from Section 5 registration, which may cause some issuers to interpret "reasonable steps to verify" in a manner that is more burdensome than if specific verification methods were prescribed, thus incurring higher cost. Similarly, some issuers may decide to use additional internal or external resources (e.g., retaining lawyers, soliciting opinions, etc.) that they would not have used if specific verification methods were prescribed or if a non-exclusive list of methods was provided, in order to make sure they are compliant with the rule, which would also increase their costs.

To the extent that issuers require investors to provide personally identifiable information (e.g., Social Security numbers, tax information, bank or brokerage account information) in order to verify their accredited investor status, these investors may be reluctant to do so in the context of making an investment in an issuer, particularly an issuer with which they may have no prior relationship.[130] In addition to concerns about maintaining personal privacy, investors may be concerned that their personally identifiable information could be stolen or accessed by third parties or used by unscrupulous issuers in various ways (e.g., identity theft, which could impose costs to investors that go well beyond the costs typically associated with investing). As a consequence, some potential investors may elect not to participate in this market, thus impeding capital formation to some extent.

As there is no information available to us on the costs currently incurred by issuers to form a reasonable belief that a purchaser in a Rule 506 offering is an accredited investor, we are unable to quantify the estimated costs and benefits of the verification requirement in proposed Rule 506(c). We are requesting comment from the public on this issue.

### E. Form D Check Box for Rule 506(c) Offerings

Much of what we know about the size and characteristics of the private offering market comes from Form D filings. The information collected to date and described in this release illustrates and underscores the importance of the private offering market in the U.S. economy. The continued collection of this information following the elimination of the prohibition against general solicitation in Rule 506(c) and Rule 144A

[130] Letter from SecondMarket.

offerings will be an important monitoring tool in assessing the ongoing economic impact of the new rules. We are proposing to amend Form D to add a new check box in Item 6 of Form D, which would require an issuer to indicate whether it is relying on Rule 506(c) in conducting its offering. This information would assist the Commission in monitoring the use of proposed Rule 506(c), and the marginal cost to issuers of providing this information is likely to be low because Form D already requires issuers to identify the exemption on which they are relying.

### F. Request for Comment

11. Are there other benefits and costs associated with the elimination of the prohibition against general solicitation that should be considered? Are those more pertinent to proposed Rule 506(c) offerings or Rule 144A offerings?

12. Is it likely that the removal of the prohibition against general solicitation would increase fraudulent activity in these markets? If so, to what extent, and what form is this fraudulent activity likely to take? Please provide data where possible.

13. How costly is it to comply with the existing requirements of Rule 506(b)? What would the incremental cost be to comply with the proposed requirements of Rule 506(c)? What would be the impact, if any, of the proposed Rule 506(c) check box on Form D? Please provide data where possible.

14. Are there any other benefits or costs associated with the accredited investor verification requirement in proposed Rule 506(c) that the Commission has not identified?

15. Do the types, or extent, of any benefits or costs from the proposed amendments to Rule 506 and Rule 144A differ depending on the type of issuer, other than as described above? If so, please explain.

16. Are there any additional economic effects related to efficiency, capital formation, or competition that the Commission has not identified?

## VIII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[131] the Commission must advise the OMB as to whether a proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment or innovation.

If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review.

We request comment on whether our proposed amendments would be a "major rule" for purposes of SBREFA. We solicit comment and empirical data on:

- the potential effect on the U.S. economy on an annual basis;
- any potential increase in costs or prices for consumers or individual industries; and
- any potential effect on competition, investment or innovation.

[131] Pub. L. No. 104-121, Tit. II, 110 Stat. 857 (1996).

We request those submitting comments to provide empirical data and other factual support for their views to the extent possible.

## IX. INITIAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared this Initial Regulatory Flexibility Analysis ("IRFA") in accordance with Section 603 of the Regulatory Flexibility Act.[132] This IRFA relates to the amendments to Rules 500, 501, 502 and 506 of Regulation D, Form D and Rule 144A that we are proposing in this release.

### A. Reasons for, and Objectives of, the Action

The primary reason for, and objective of, the proposed amendments to Rule 502 and Rule 506 is to implement the statutory requirements of Section 201(a)(1) of the JOBS Act, which directs the Commission to revise Rule 506 to provide that the prohibition against general solicitation in Rule 502(c) shall not apply to offers and sales of securities made pursuant to Rule 506, provided that all purchasers of the securities are accredited investors. Consistent with the language in Section 201(a), the proposed amendments to Rule 506 require issuers to take reasonable steps to verify that purchasers in any Rule 506 offering using general solicitation are accredited investors. The primary reason for, and objective of, the proposed amendment to Form D is to assist our efforts to monitor the use of general solicitation in Rule 506(c) offerings and the size of this offering market.

The primary reason for, and objective of, the proposed amendment to Rule 144A is to implement the statutory requirements of Section 201(a)(2) of the JOBS Act, which directs the Commission to revise Rule 144A(d)(1) to provide that securities sold pursuant to Rule 144A may be offered to persons other than QIBs, including by means of general

[132] See 5 U.S.C. 603.

solicitation, provided that securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs.

### B. Small Entities Subject to the Proposed Rule and Form Amendments

For purposes of the Regulatory Flexibility Act, under our rules, an issuer, other than an investment company, is a "small business" or "small organization" if it has total assets of $5 million or less as of the end of its most recent fiscal year and is engaged or proposing to engage in an offering of securities which does not exceed $5 million.[133] For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[134]

Proposed Rule 506(c) would affect small issuers (including both operating businesses and investment funds that raise capital under Rule 506) relying on this safe harbor from Securities Act registration. All issuers that sell securities in reliance on Regulation D are required to file a Form D with the Commission reporting the transaction. For the fiscal year ended December 31, 2011, 18,174 issuers filed an initial notice on Form D, of which 16,692 relied on the Rule 506 exemption. Based on information reported by issuers on Form D, there were 3,823 small issuers[135] relying on the Rule 506 exemption in 2011. This number likely underestimates the actual number of small issuers relying on the Rule 506 exemption, however, because over 50% of issuers declined to report their size.

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[133] 17 CFR 230.157.

[134] 17 CFR 270.0-10(a).

[135] Of this number, 3,344 of these issuers are not investment companies, and 479 are investment companies.

The proposed amendment to Rule 144A would affect small entities that engage in Rule 144A offerings.[136] Unlike issuers that use Regulation D, issuers conducting Rule 144A offerings are not required to file any form with the Commission. This lack of data significantly limits our ability to assess the number and the size of issuers that use Rule 144A offerings. Still, we are able to obtain some data on Rule 144A offerings during the 2009 to 2011 period from two commercial databases.[137] Based on these data, we identified 681 offerings involving 607 issuers from 2009 to 2011. Of these 607 issuers, only 316 provided information on their total assets. With respect to these 316 issuers, we identified 42 issuers with total assets of less than $50 million.

### C. Projected Reporting, Recordkeeping and Other Compliance Requirements

The proposed amendments to Rule 506 would impose certain reporting and compliance requirements on issuers that engage in general solicitation in Rule 506 offerings. As discussed above, issuers taking advantage of proposed Rule 506(c) to engage in general solicitation in Rule 506 offerings would be required to take reasonable steps to verify that the purchasers of the securities are accredited investors. The steps required would vary with the circumstances, but we anticipate that some potential investors may have to provide more information to issuers than they currently provide, while issuers may have to apply a stricter and more costly process to verify accredited investor status than what they currently use. We expect that the costs of compliance

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136 While it may be theoretically possible for a small entity to meet one part of the definition of "qualified institutional buyer" (e.g., an "entity, all of the equity owners of which are qualified institutional buyers, acting for its own account or the accounts of other qualified institutional buyers"), we do not have any information to suggest that there are such small entities. Accordingly, the regulatory flexibility analysis in regard to Rule 144A is focused on small issuers that engage in Rule 144A offerings.

137 Thomson Financial's SDC Platinum Service and Sagient Research System's Placement Tracker database.

would vary depending on the size and nature of the offering, the nature and extent of the verification methods used, and the number and nature of potential purchasers in the offering. Proposed Rule 506(c) does not impose any recordkeeping requirements. However, we anticipate that issuers would document the steps they take to verify that purchasers are accredited investors in Rule 506 offerings involving general solicitation.

The proposed amendment to Form D would also impose an information requirement with respect to Rule 506 offerings that use general solicitation. Each issuer submitting a Form D for a Rule 506 offering would be required to check a box on the form to indicate whether the issuer is relying on the proposed Rule 506(c) exemption. We do not believe that this proposed revision to Form D would increase in any material way the time or information required to complete the Form D that must be filed with the Commission in connection with a Rule 506 offering.

The proposed amendment to Rule 144A contains no reporting, recordkeeping or compliance requirements for issuers that engage in Rule 144A offerings.

### D. Duplicative, Overlapping or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate, overlap or conflict with the proposed amendments to Rule 144A, Form D, and Rules 500, 501, 502 and 506 of Regulation D.

### E. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives of our amendments, while minimizing any significant adverse impact on small entities. In regard to the proposed amendment to Rule 144A and the proposed amendment to Rule 506 to remove the prohibition against general solicitation in Rule 506 offerings where all purchasers are accredited investors, there are no significant alternatives to these amendments that would accomplish the stated objectives of Section 201(a) of the JOBS Act.

In connection with the proposed amendment to Form D and the proposed amendment to Rule 506 that requires issuers to take reasonable steps to verify that purchasers of securities are accredited investors, the Commission considered the following alternatives: (1) establishing different compliance or reporting standards that take into account the resources available to small entities; (2) clarifying, consolidating or simplifying compliance requirements under the rule; (3) using design rather than performance standards; and (4) exempting small entities from coverage of all or part of the proposed amendment to Rule 506.

With respect to using design rather than performance standards, we note that the "reasonable steps to verify" requirement in proposed Rule 506(c) is a performance standard. We believe that the flexibility of a performance standard accommodates different types of offerings and purchasers without imposing overly burdensome methods that may be ill-suited or unnecessary to a particular offering or purchaser, given the facts and circumstances. The Commission is not proposing the establishment of different compliance or reporting requirements or timetables for the rule, as proposed, for small entities. The particular steps necessary to meet the proposed requirement to take reasonable steps to verify that purchasers are accredited investors would vary according to the circumstances. Different compliance requirements for small entities may create the risk that the requirements may be too prescriptive or, alternatively, insufficient to verify a purchaser's accredited investor status. Special requirements for small entities may also lead to investor confusion or reduced investor confidence in Rule 506 offerings if they create the impression that small entities have a different standard of verification than other issuers of securities. As the verification requirement is intended to protect investors by limiting participating in unregistered offerings to those who are most able to bear the risk, we are preliminarily of the view that a flexible standard applicable to all issuers better accomplishes the goal of investor protection that this requirement is intended to serve. The Commission is not proposing a different reporting requirement for small entities because the additional information that would be required in the Form D is minimal and should not be unduly burdensome or costly for small entities.

We similarly believe that it does not appear consistent with the objective of the proposed amendments or the considerations described above regarding investor confusion and investor confidence to further clarify, consolidate or simplify the amendments for small entities. With respect to exempting small entities from coverage of these proposed amendments, we believe such an approach would be contrary to the requirements of, and the legislative intent behind, Section 201(a), as evidenced by the plain language of the statute.

### F. General Request for Comment

The Commission is soliciting comments regarding this analysis. The Commission requests comment on the number of small entities that would be subject to the rules and whether the proposed rules would have any effects that have not been discussed. The Commission requests that commentators describe the nature of any effects on small entities subject to the rules and provide empirical data to support the nature and extent of the effects.

## X. STATUTORY AUTHORITY AND TEXT OF PROPOSED RULE AND FORM AMENDMENTS

The amendments contained in this release are being proposed under the authority set forth in Sections 4(a)(1), 4(a)(2) and 19 of the Securities Act, as amended, and Section 201(a) of the JOBS Act.

**List of Subjects in 17 CFR Parts 230 and 239**

Reporting and recordkeeping requirements, Securities.

For the reasons set out above, the Commission proposes to amend Title 17, chapter II of the Code of Federal Regulations, as follows:

**PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933**

1. The general authority citation for Part 230 is revised to read as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z–3, 77sss, 78c, 78d, 78j, 78 l, 78m, 78n, 78o, 78o–7 note, 78t, 78w, 78 ll (d), 78mm, 80a–8, 80a–24, 80a–28, 80a–29, 80a–30, and 80a–37, and Pub. L. No. 112-106, § 201(a), 126 Stat. 313 (2012), unless otherwise noted.

* * * * *

2. Amend § 230.144A by:

a. Removing the reference to "section 4(2)" and adding in its place "section 4(a)(2)" in Preliminary Note 7;

b. Removing the reference to "section 2(13)" and adding in its place "section 2(a)(13)" in paragraph (a)(1)(i)(A);

c. Removing the reference to "sections 2(11) and 4(1)" and adding in its place "sections 2(a)(11) and 4(a)(1)" in paragraph (b);

d. Removing the references to "section 4(3)(C)," "section 2(11)" and "section 4(3)(A)" and adding in their place "section 4(a)(3)(C)," "section 2(a)(11)" and "section 4(a)(3)(A)," respectively, in paragraph (c);

e. Removing the phrase "offered or" after the phrase "The securities are" in paragraph (d)(1); and

f. Removing the phrase "an offeree or" after the phrase "a qualified institutional buyer or to" and adding in its place "a" in paragraph (d)(1).

* * * * *

3. Amend § 230.500(c) by removing the reference to "section 4(2)" and adding in its place "section 4(a)(2)".

* * * * *

4. Amend § 230.501 by:

a. Removing the reference to "section 2(13)" and adding in its place "section 2(a)(13)" in paragraph (a)(1); and

b. Removing the reference to "section 2(4)" and adding in its place "section 2(a)(4)" in paragraph (g).

* * * * *

5. Amend § 230.502 by:

a. Removing the reference to "§ 230.506" and adding in its place "§ 230.506(b)" in paragraph (b)(1);

b. Removing the reference to "§ 230.506" and adding in its place "§ 230.506(b)" in paragraph (b)(2)(iv);

c. Removing the reference to "§ 230.506" and adding in its place "§ 230.506(b)" in paragraph (b)(2)(v);

d. Removing the reference to "§ 230.506" and adding in its place "§ 230.506(b)" in the first sentence of paragraph (b)(2)(vii);

e. Adding to the first sentence of paragraph (c) the phrase "or § 230.506(c)" after the phrase "Except as provided in § 230.504(b)(1)";

f. Removing the reference to "section 4(2)" and adding in its place "section 4(a)(2)" in paragraph (d); and

g. Removing the reference to "section 2(11) of the Act" and adding in its place "section 2(a)(11) of the Act" in paragraph (d).

* * * * *

6. Amend § 230.506 by:

a. Adding to paragraph (a) the phrase "or paragraph (c)" after the phrase "satisfy the conditions in paragraph (b)";

b. Removing the reference to "section 4(2)" and adding in its place "section 4(a)(2)" in paragraph (a);

c. Adding to paragraph (b) the phrase "in offerings not using general solicitation or general advertising" after the phrase "Conditions to be met";

d. Removing the reference to "this section" and adding in its place "§ 230.506(b)" in the note to paragraph (b)(2)(i); and

e. Adding paragraph (c).

The addition reads as follows:

**§ 230.506 Exemption for limited offers and sales without regard to dollar amount of offering.**

* * * * *

(c) Conditions to be met in offerings using general solicitation or general advertising.

(1) General conditions. To qualify for exemption under this section, sales must satisfy all the terms and conditions of §§ 230.501 and 230.502(a) and (d).

(2) Specific conditions.

(i) Nature of purchasers. All purchasers of securities sold in any offering under this § 230.506(c) are accredited investors.

(ii) Verification of accredited investor status. The issuer shall take reasonable steps to verify that purchasers of securities sold in any offering under this § 230.506(c) are accredited investors.

**PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933**

7. The authority citation for Part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 77z–3, 77sss, 78c, 78 l, 78m, 78n, 78 o (d), 78o–7 note, 78u–5, 78w(a), 78 ll, 78mm, 80a–2(a), 80a–3, 80a–8, 80a–9, 80a–10, 80a–13, 80a–24, 80a–26, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

8. Amend Form D (referenced in § 239.500) by:

a. Removing the phrase "Rule 506" and adding in its place "Rule 506(b)" next to the appropriate check box;

b. Removing the phrase "Securities Act Section 4(5) and adding in its place "Securities Act Section 4(a)(5)" next to the appropriate check box; and

c. Adding a check box that reads “Rule 506(c)” between the revised “Rule 506(b)” check box and the revised “Securities Act Section 4(a)(5)” check box.

(Note: The text of Form D does not, and the amendments will not, appear in the Code of Federal Regulations.)

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

August 29, 2012

Commissioner Aguilar not participating

**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT 1934**
**Release No. 67748 / August 29, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-14999**

| | |
|---|---|
| **In the Matter of**<br><br>**ANGELICA AGUILERA,**<br><br>**Respondent.** | **ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING** |

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Angelica Aguilera ("Respondent" or "Aguilera").

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. <u>RESPONDENT</u>**

1. <u>Aguilera</u>, age 46, resides in Boca Raton, Florida. From March 2004 until April 2010, Aguilera was a shareholder and Financial & Operations Principal of LatAm Investments Inc. ("LatAm"), a broker-dealer registered with the Commission. Beginning in October 2007, she served as President until the firm ceased operations in 2010. Aguilera has held Series 7, 24, and 27 licenses.

## B. OTHER RELEVANT ENTITY AND INDIVIDUALS

2. LatAm is a Florida Limited Liability Company formed in 2004, which had its principal place of business in Miami, Florida. LatAm was registered as a broker-dealer in October 2004 under the name Acosta Financial Services, Inc., and changed its name to LatAm in October 2007. In January 2010, LatAm ceased trading operations. LatAm was a small broker-dealer, with only approximately 10 to 15 employees. In April 2010, LatAm filed a Form BD-W, withdrawing its registration with the SEC.

3. Fabrizio Neves, age 43, is a resident of Brazil. From approximately May 2006 until November 2009, Neves was a shareholder and registered representative associated with LatAm. During the relevant period, Neves held Series 7 and 66 licenses. In May 2010, FINRA barred Neves, by consent, from association with any FINRA member firm in any capacity.

4. Jose Luna, age 45, is a resident of Aventura, Florida. Neves brought Luna to LatAm in May 2006, where Luna worked as a back office operations employee. In May 2008, Luna obtained his Series 7 license and, thereafter, worked as Operations Manager at LatAm, assisting Neves in executing trades for his customers. Luna left LatAm in December 2009. In June 2010, FINRA barred Luna, by consent, from association with any FINRA member firm in any capacity.

## C. OVERVIEW

5. This proceeding arises out of Aguilera's failure reasonably to supervise Neves and Luna at LatAm. From at least November 2006 through September 2009, Neves and Luna engaged in a fraudulent markup and markdown scheme to defraud two Brazilian public pension funds ("Brazilian Funds") and another foreign institutional customer in the offer, purchase and sale of structured notes.

6. Neves was the mastermind of the scheme and Luna assisted and participated in it with him. They charged excessive undisclosed markups and a markdown to these three customers ranging from 19 to 67 percent. Neves and Luna used offshore nominee accounts as intermediaries, and physically altered the original pricing information in the structured note term sheets transmitted to the customers' representatives to conceal their scheme.

7. Neves and Luna violated Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, and willfully aided and abetted violations of Section 15(c)(1) of the Exchange Act by charging undisclosed excessive markups and a markdown to LatAm's customers in connection with the structured note transactions. As a result of Neves and Luna's misconduct, the Brazilian Funds and the other institutional investor paid approximately $36 million more to purchase structured notes than LatAm paid the notes' issuers for them, $29 million of which they paid during the period Aguilera supervised Neves and Luna.

8. Part of Neves and Luna's scheme, from October 2007 through September 2009, occurred while Aguilera was LatAm's President and was the immediate supervisor of Neves and Luna. Neves and Luna's fraudulent markup and markdown scheme included eight transactions between July 2008 and September 2009.

9. Aguilera did not prevent or detect Neves and Luna's fraudulent scheme due to Aguilera's failure to supervise Neves and Luna and her failure to effectively implement LatAm's policies and procedures in a manner that would reasonably be expected to prevent and detect undisclosed excessive markups and markdowns by its traders.

10. In particular, Aguilera failed to oversee Neves and Luna in connection with the markups and markdown on structured products charged to the Brazilian Funds and another foreign institutional customer. In addition, she failed to effectively implement LatAm's policies and procedures because the firm's chief compliance officer, to whom she delegated compliance responsibility to review markups and markdowns, lacked supervisory authority over Neves and Luna and could not take meaningful action to address any excessive markups and markdowns he detected. Moreover, Aguilera was aware that the chief compliance officer was not in the office on a regular basis and that he was deficient in his day to day compliance responsibilities. Aguilera failed to effectively delegate supervisory authority over Neves and Luna to anyone at LatAm and thus retained all supervisory responsibility for them. As a result, Aguilera failed reasonably to supervise Neves and Luna within the meaning of Section 15(b)(4)(E) as incorporated by Section 15(b)(6) of the Exchange Act.

## D. BACKGROUND OF LATAM

11. In 2004, Aguilera and another individual (the "Part-Owner") formed LatAm as a small Miami-based broker-dealer. Although LatAm traded various types of securities, its primary business involved the trading of fixed income securities, including bonds, treasuries, and structured notes, on a riskless principal basis for customers, many of who were located in Latin America.

12. In May 2006, Neves joined LatAm as a registered representative and brought with him the customer accounts of the Brazilian Funds, which became the firm's largest customers and generated the vast majority of the firm's revenues through the trading of structured notes and other investments. Neves sought a majority ownership in LatAm, but he failed to pass the Series 24 examination, a requirement for assuming a controlling interest in the firm. However, based on an agreement between Aguilera, the Part-Owner and Neves, Neves received approximately 90% of the firm's commissions and determined the salaries for Aguilera and others.

13. After Neves joined the firm and began trading for the Brazilian Funds, LatAm reported a substantial increase in revenues. Before Neves was associated with the firm, LatAm generated revenues of only $34,803 in 2005 and $72,981 in the first quarter of 2006. After Neves joined LatAm, its revenues grew substantially to more than $4 million for 2006.

14. LatAm's revenues continued to grow to nearly $8 million in 2007 and $13 million in

order to conceal the actual markup charged to the end customer. Neves told Luna what prices to use and approved the alterations before Luna sent them to the customer. Luna used "white out" or electronic "cut and paste" to change or omit the original term sheets' pricing information.

22. As a result of the markup scheme, between July 2008 and September 2009, the Brazilian Funds and another other foreign institutional customer paid approximately $29 million in undisclosed, excessive fees including markups, and in one instance, a markdown, between 19 and 67 percent.

## F. AGUILERA FAILED REASONABLY TO SUPERVISE NEVES AND LUNA

23. Aguilera was LatAm's President and served as the direct supervisor for Neves and Luna from October 2007 to September 2009. At the time, LatAm had only approximately 10 to 15 employees. Pursuant to LatAm's supervisory policies and procedures, Aguilera maintained responsibility for the "hiring, registration and supervision of registered representatives," including Neves and Luna. Additionally, as President, Aguilera maintained ultimate responsibility for developing and implementing the firm's supervisory policies and procedures.

24. Aguilera failed reasonably to supervise Neves and Luna with a view to preventing and detecting their antifraud violations because she failed to effectively follow or implement LatAm's policies and procedures to ensure the fairness of markups and markdowns charged by Neves and Luna to LatAm's customers. LatAm's supervisory policies and procedures required, among other things, a thorough review of trade blotters and an evaluation of the fairness of markups and markdowns charged to customers. As Neves and Luna's direct supervisor, Aguilera was responsible for following this supervisory policy. However, she failed to take reasonable steps to conduct a thorough review of trade blotters or evaluate the fairness of markups and markdowns that Neves and Luna charged to LatAm's customers.

25. While Aguilera maintained supervisory responsibility over Neves and Luna, she delegated compliance responsibility for reviewing markups and commissions to the firm's chief compliance officer. That individual, however, lacked supervisory authority over Neves and Luna and therefore lacked the ability to reverse or correct questionable transactions.

26. Aguilera failed to effectively implement LatAm's policies and procedures because: (1) the individual to whom she delegated compliance responsibility lacked the authority and ability to take meaningful action to address excessive markups and markdowns charged to LatAm's customers by Neves and Luna; (2) even if the individual detected suspicious activity, he was required to report the activity to Aguilera; and (3) the individual did not have the authority and ability to take any disciplinary action against Neves or Luna. Moreover, Aguilera was aware that he was not in the office on a regular basis and that he was deficient in his day to day compliance responsibilities, including maintaining complete customer files.

27. Aguilera failed reasonably to follow or implement the firm's supervisory policies and procedures with respect to monitoring the fairness of markups and markdowns charged by Neves and Luna and they were able to carry out the fraudulent markup scheme undetected.

28. Aguilera profited from Neves and Luna's fraudulent markup scheme in the form of bonus payments that Aguilera received based, in part, on profits generated from the scheme.

### G. VIOLATIONS

29. As a result of the conduct described above, Neves and Luna willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, which prohibit fraudulent conduct in the purchase or sale of securities, and willfully aided and abetted LatAm's violations of Section 15(c)(1) of the Exchange Act, which prohibits a broker-dealer from using interstate facilities or the mails to effect or induce transactions in securities by means of any manipulative, deceptive, or other fraudulent device or contrivance.

30. As a result of the conduct described above, Aguilera failed reasonably to supervise Neves and Luna, within the meaning of Section 15(b)(4)(E) as incorporated by reference in Section 15(b)(6) of the Exchange Act, with a view to preventing and detecting their violations of the antifraud provisions of the securities laws.

## III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement with prejudgment interest and civil penalties pursuant to Section 21B of the Exchange Act.

## IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him or her upon consideration of this Order, the allegations of which may be deemed to be true as

provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 232

[Release Nos. 33-9353; 34-67747; 39-2485; IC-30185]

# Adoption of Updated EDGAR Filer Manual

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission (the Commission) is adopting revisions to the Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) Filer Manual and related rules to reflect updates to the EDGAR system. The revisions are being made primarily to support submission of Confidential Registration Statements; require Form ID authentication documents in PDF format; automate LTID generation for Large Trader registrations; support minor updates to Form D; remove superseded XBRL Taxonomies; remove the OMB expiration date from Form TA-1, TA-2, TA-W, 25-NSE; and request of unused funds. The EDGAR system is scheduled to be upgraded to support this functionality on July 2, 2012.

**EFFECTIVE DATE:** [Insert date of publication in the Federal Register.] The incorporation by reference of the EDGAR Filer Manual is approved by the Director of the Federal Register as of [Insert date of publication in the Federal Register].

**FOR FURTHER INFORMATION CONTACT:** In the Division of Corporation Finance, for questions on Confidential Registration Statement, Form ID, and Forms D contact Jeffrey Thomas, Office of Information Technology, at (202) 551-3600; in the Division of Risk, Strategy, and Financial Innovation for questions concerning XBRL Taxonomies contact Walter Hamscher, at (202) 551-5397; in the Division of Trading and Markets for questions concerning Form 13H contact Richard R. Holley III, at (202) 551-5614, for questions concerning Form TA contact

Kenneth Riitho, at (202) 551-5592; and in the Office of Information Technology, contact Rick Heroux, at (202) 551-8800.

**SUPPLEMENTARY INFORMATION:** We are adopting an updated EDGAR Filer Manual, Volume I and Volume II. The Filer Manual describes the technical formatting requirements for the preparation and submission of electronic filings through the EDGAR system.[1] It also describes the requirements for filing using EDGARLink Online and the Online Forms/XML website. We also are making conforming changes to Rules 10[2] and 101[3] of Regulation S-T[4] relating to the Form ID authentication process.

The revisions to the Filer Manual reflect changes within Volume I entitled EDGAR Filer Manual, Volume I: "General Information," Version 13 (July 2012) and Volume II entitled EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 20 (July 2012). The updated manual will be incorporated by reference into the Code of Federal Regulations.

The Filer Manual contains all the technical specifications for filers to submit filings using the EDGAR system. Filers must comply with the applicable provisions of the Filer Manual in order to assure the timely acceptance and processing of filings made in electronic format.[5] Filers

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[1] We originally adopted the Filer Manual on April 1, 1993, with an effective date of April 26, 1993. Release No. 33-6986 (April 1, 1993) [58 FR 18638]. We implemented the most recent update to the Filer Manual on March 30, 2012. See Release No. 33-9303 (March 26, 2012) [77 FR 19077].

[2] 17 CFR 232.10.

[3] 17 CFR 232.101.

[4] 17 CFR Part 232.

[5] See Rule 301 of Regulation S-T (17 CFR 232.301).

may consult the Filer Manual in conjunction with our rules governing mandated electronic filing when preparing documents for electronic submission.[6]

The EDGAR system will be upgraded to Release 12.1 on July 2, 2012 and will introduce the following changes: EDGAR will be updated to support submission of confidential draft registration statements for companies that qualify either under the JOBS Act or the Division of Corporate Finance's foreign private issuer policy. Draft registration statements and amendments must be submitted using submission form types DRS and DRS/A. These confidential submission types can be accessed from the EDGAR Filing website, by selecting the "Draft Reg. Statement" link. New filers may select the "Access Codes will be used to submit draft registration" option on the Form ID application to indicate that they are submitting an application for EDGAR access to file Draft Registration Statements. If the filers already have an assigned EDGAR Central Index Key (CIK), then they must use the existing CIK.

EDGAR and Regulation S-T will require the authenticating document for Form ID submissions to be submitted in electronic format as a Portable Document Format (PDF) attachment. Filers would no longer be permitted to fax the Form ID authentication documents for new requests to apply for EDGAR access, update passphrase, convert paper only filer to electronic filer, and access for new serial companies.[7]

EDGAR will assign a unique Large Trader identification ("LTID") number to any person or entity that files a new Form 13H initial filing. The acceptance email notification that EDGAR sends to the filer will include the assigned LTID number. On future 13H-A and 13H-Q filings, the

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[6] See Release No. 33-9303 (March 26, 2012) [77 FR 19077] in which we implemented EDGAR Release 12.0. For additional history of Filer Manual rules, please see the cites therein.

[7] In addition to changing the Filer Manual provisions, we also are amending Rule 10(b)(2) [17 CFR 232.10(b)(2)] and Rule 101(a)(1)(ix) [17 CFR 232.101(a)(1)(ix)] of Regulation S-T to eliminate references to faxing the required authentication document.

system will pre-populate the previously assigned LTID number which will be unalterable by the registrant.

In addition, Form 13H's Taxpayer Identification Number field will accept a nine-digit Social Security Number if a filer does not have a ten-digit Taxpayer Identification Number without requiring the filer to use a placeholder digit. For Item 1(a), if filers indicate Investment Adviser as their business, they can further indicate their type of advisory business to involve "Registered Investment Companies" and/or "Hedge Funds or other Funds not registered under the Investment Company Act." This field, which currently allows only one of these two options to be selected, will now allow both options to be selected. Finally, the OMB Number and the Paperwork Reduction Act Disclosures on the Instructions page of Form 13H will be updated.

EDGAR will no longer support US GAAP Taxonomy 1.0, US Financial Reporting Taxonomy Framework (USFRTF) 2005, US GAAP Taxonomy 2009, US Schedule of Investments (SOI) Taxonomy 2008, Risk Return Taxonomy 2008, and Risk Return Taxonomy 2006.

Form D screens and instructions will be updated for Item 6 to replace the reference to "Securities Act Section 4(6)" with "Securities Act Section 4(5)" as per Release No. 33-9287.

The OMB expiration date will no longer be displayed on the Forms TA-1, TA-2, TA-W, and 25-NSE. These forms will continue to display other OMB Approval information. In addition, Forms 3, 4, and 5 will no longer refer to Public Utility Holding Company Act (PUHCA).

Filers will be able to view their account balance along with the date and amount of their most recent deposit. Filers will also able to view their account activity statement for the previous twelve months. Additionally, filers will be able to request the return of unused funds. These options will be available on the 'Retrieve/Edit Company and Submission Data' functionality of the EDGAR Filing website.

The deployment of EDGAR Release 12.0.1, originally planned for July 9, 2012 to implement an online version of Form N-SAR, is being delayed until the fourth quarter of this calendar year. The specific deployment date will be announced on the Commission's public web site's "Information for EDGAR Filers" page (http://www.sec.gov/info/edgar.shtml). Filers should continue to use the EDGAR Filer Manual, Volume III: N-SAR Supplement to file their N-SAR submissions. When the online version of Form N-SAR is deployed, EDGAR Filer Manual, Volume III: N-SAR Supplement will be retired. Instructions to file the online version of Form N-SAR addressed in Chapter 9 of EDGAR Filer Manual, Volume II: EDGAR Filing should then be followed.

Along with the adoption of the Filer Manual, we are amending Rule 301 of Regulation S-T to provide for the incorporation by reference into the Code of Federal Regulations of today's revisions. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51.

You may obtain paper copies of the updated Filer Manual at the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Room 1543, Washington DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. We will post electronic format copies on the Commission's website; the address for the Filer Manual is http://www.sec.gov/info/edgar.shtml.

Since the Filer Manual and the corresponding rule changes relate solely to agency procedures or practice, publication for notice and comment is not required under the Administrative Procedure Act (APA).[8] It follows that the requirements of the Regulatory Flexibility Act[9] do not apply.

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[8] 5 U.S.C. 553(b).

The effective date for the updated Filer Manual and the rule amendments is [Insert date of publication in the Federal Register]. In accordance with the APA,[10] we find that there is good cause to establish an effective date less than 30 days after publication of these rules. The EDGAR system upgrade to Release 12.1 is scheduled to become available on July 2, 2012. The Commission believes that establishing an effective date less than 30 days after publication of these rules is necessary to coordinate the effectiveness of the updated Filer Manual with the system upgrade.

Statutory Basis

We are adopting the amendments to Regulation S-T under Sections 6, 7, 8, 10, and 19(a) of the Securities Act of 1933,[11] Sections 3, 12, 13, 14, 15, 23, and 35A of the Securities Exchange Act of 1934,[12] Section 319 of the Trust Indenture Act of 1939,[13] and Sections 8, 30, 31, and 38 of the Investment Company Act of 1940.[14]

List of Subjects in 17 CFR Part 232

Incorporation by reference, Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENTS

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

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[9] 5 U.S.C. 601- 612.

[10] 5 U.S.C. 553(d)(3).

[11] 15 U.S.C. 77f, 77g, 77h, 77j, and 77s(a).

[12] 15 U.S.C. 78c, 78l, 78m, 78n, 78o, 78w, and 78ll.

[13] 15 U.S.C. 77sss.

[14] 15 U.S.C. 80a-8, 80a-29, 80a-30, and 80a-37.

**PART 232 - REGULATION S-T—GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS**

1. The authority citation for Part 232 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z–3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a–6(c), 80a–8, 80a–29, 80a–30, 80a–37, and 7201 et seq.; and 18 U.S.C. 1350.

* * * * *

2. Section 232.10 is amended by revising paragraph (b)(2), to read as follows:

**§232.10 Application of part 232.**

* * * * *

(b)(1) * * * * *

(2) File, by uploading as a Portable Document Format (PDF) attachment to the Form ID filing, a notarized document, manually signed by the applicant over the applicant's typed signature, that includes the information required to be included in the Form ID filing and confirms the authenticity of the Form ID filing.

* * * * *

3. Section 232.101 is amended by revising paragraph (a)(1)(ix), to read as follows:

(a) Mandated electronic submissions. (1) * * * * *

(ix) Form ID (§§239.63, 249.446, 269.7 and 274.402 of this chapter); the Form ID authenticating document required by Rule 10(b) of Regulation S–T (§232.10(b)) also shall be filed in electronic format as an uploaded Portable Document Format (PDF) attachment to the Form ID filing. Other related correspondence and supplemental information submitted after the Form ID filing shall not be submitted in electronic format;

* * * * *

4. Section 232.301 is revised to read as follows:

**§232.301 EDGAR Filer Manual.**

Filers must prepare electronic filings in the manner prescribed by the EDGAR Filer Manual, promulgated by the Commission, which sets out the technical formatting requirements for electronic submissions. The requirements for becoming an EDGAR Filer and updating company data are set forth in the updated EDGAR Filer Manual, Volume I: "General Information," Version 13 (July 2012). The requirements for filing on EDGAR are set forth in the updated EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 20 (July 2012). All of these provisions have been incorporated by reference into the Code of Federal Regulations, which action was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51. You must comply with these requirements in order for documents to be timely received and accepted. You can obtain paper copies of the EDGAR Filer Manual from the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Room 1543, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Electronic copies are available on the Commission's website. The address for the Filer Manual is http://www.sec.gov/info/edgar.shtml. You can also inspect the document at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, call 202–741–6030, or go to: http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

August 29, 2012

Commissioner Aguilar
Commissioner Gallagher
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67761 / August 30, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3451 / August 30, 3012

INVESTMENT COMPANY ACT OF 1940
Release No. 30187 / August 30, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14520

In the Matter of

MATTHEW CRISP,

Respondent.

ORDER MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940.

I.

On August 29, 2011, the Securities and Exchange Commission ("Commission") deemed it appropriate and in the public interest that public administrative and cease-and-desist proceedings be instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Matthew Crisp ("Respondent" or "Crisp").

II.

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

### Summary

1. In this matter, Crisp exploited undisclosed conflicts of interest for his personal gain. While working as a partner and fiduciary of Adams Street Partners, LLC ("Adams Street"), a registered investment adviser to multiple private equity funds, Crisp and a friend secretly formed a private investment vehicle called AV Partners LP. Crisp then usurped from Adams Street's funds, for AV Partners, a lucrative investment opportunity in a private company. Crisp concealed the misappropriation with misrepresentations and omissions regarding at least four material facts: (1) that Crisp redirected the investment opportunity from Adams Street's funds to AV Partners; (2) Crisp's involvement with AV Partners, and the resulting conflicts of interest; (3) that Crisp was motivated by personal profits and conflicting loyalties, not a purported prior commitment, when steering the investment opportunity to AV Partners; and (4) that Crisp's conduct violated provisions of Adams Street's Integrity Policy and the limited partnership agreements for Adams Street's funds.

2. Crisp further enriched himself with a personal payment of $150,000 during a later buyout of the same private company. That money should have gone to Adams Street to reduce the fees due from its private equity funds. Crisp's deceit also secured for AV Partners a second investment opportunity in another private company in which Adams Street's funds invested. Further, Crisp attempted to arrange a second payout to AV Partners from that same company. Although later forced to repay the money, Crisp initially profited by over $2 million from this conduct, at the expense of Adams Street and its private equity funds.

### Respondent

3. Crisp, age 40, resides in Hillsborough, California. He was a partner in Adams Street from June 2006 until his termination in March 2008. Crisp earned both a B.S. and a M.S. from the University of Virginia.

### Other Relevant Entities

4. Adams Street is a Delaware limited liability company headquartered in Chicago, Illinois. Adams Street has been registered with the Commission as an investment adviser since November 2000. Adams Street is the Management Company for, and Managing Member of the General Partner of, multiple private equity funds primarily for institutional investors, including Adams Street V, L.P.; Adams Street 2006 Direct Fund, L.P.; and Adams Street 2007 Direct Fund, L.P. Among others things, Adams Street's funds make direct investments in private companies that are seeking venture capital, growth equity, or additional liquidity.

5. AV Partners LP ("AV Partners") is an unregistered investment club established orally by Crisp and a friend, Joseph Wolf, to make investments together. It was never formally constituted as a limited partnership (or other type of entity).

## Background

*Adams Street Hired Crisp*

6. In June 2006, Adams Street hired Crisp as a partner assigned to its direct investment group. Crisp located technology and growth equity companies for Adams Street's private equity funds to invest in, he advised in which opportunities Adams Street's funds should invest, he executed on and managed the investment transactions on behalf of Adams Street and its funds, and he monitored the companies after the initial investments. As an investment adviser, and as an associated person to a registered investment adviser, Crisp owed fiduciary duties to Adams Street's funds.

*Crisp and Wolf Secretly Formed AV Partners*

7. Towards the end of 2006, Crisp and Wolf discussed forming AV Partners. They orally established the entity as an informal investment club to make investments together. In February and March 2007, they circulated draft partnership agreements, which they do not appear to have executed. The initials "A" and "V" are the first letters of the first names of Wolf's daughter and Crisp's son, respectively.

8. Wolf provided the initial funds for AV Partners's investments. Crisp provided access to and analysis of potential deals. Both decided what investments to make. After Wolf was repaid his initial investment money, Crisp and Wolf shared profits evenly. Crisp and Wolf shared losses evenly. Crisp therefore had a direct interest in AV Partners's investments.

9. Crisp's fiduciary duties and Adams Street's policies required him to disclose to Adams Street personal investments and any conflicts of interest, including Crisp's involvement with AV Partners. Adams Street's policies required both annual and quarterly disclosure forms, which Crisp completed. Crisp, however, consistently concealed from Adams Street and its employees his interest in, and involvement with, AV Partners. Crisp knew that his deceit in turn led Adams Street not to disclose AV Partners to Adams Street's private equity funds, and thus to the funds' investors.

10. Crisp failed to make the required disclosures to Adams Street and its funds, despite knowing that Wolf had disclosed AV Partners to the compliance department of his employer, a registered investment adviser to a registered investment company. On or around May 7, 2007, Wolf asked Crisp to send Wolf a copy of a private placement memorandum so that Wolf could provide it to his own compliance department.

11. Moreover, as detailed below, on at least three occasions in two separate transactions, Crisp lied about his involvement with AV Partners.

*Crisp Usurped a Lucrative Investment Opportunity from Adams Street's Funds for AV Partners with Material Misrepresentations and Omissions*

12. In 2006 and 2007, Crisp worked on an Adams Street investment in the VIP Tour Company, which operated a secondary market ticket brokerage business called TicketsNow (the "TicketsNow transaction"). Adams Street typically assigned a lead sponsor, who was primarily responsible for the deal, and a co-sponsor, who provided support, to each potential transaction. In the TicketsNow transaction, Crisp served as lead sponsor. Another Adams Street partner served as co-sponsor.

13. As lead sponsor on the TicketsNow transaction, Crisp met with Adams Street's Direct Investment Team to discuss the transaction, co-authored (with the deal co-sponsor) a memorandum recommending the investment to Adams Street's Investment Committee, and took the lead on otherwise communicating with Adams Street personnel about the transaction. The memorandum to the Investment Committee that Crisp co-authored advised about the company and the market sector, and recommended that Adams Street's funds invest in TicketsNow. The Investment Committee decided, as the Management Company and Managing Member of the General Partner, to invest Adams Street's funds' money in the TicketsNow transaction.

14. To win the opportunity to invest in TicketsNow, in 2006 Adams Street committed to invest a total of $15 million from its private equity funds. This total commitment exceeded Adams Street's typical investment amount for its funds. As a result, in or around December 2006, Adams Street's partners decided to syndicate to (or, share with) other investors a portion of the $15 million total commitment. Around this time, the Adams Street investment committee decided that Adams Street should syndicate up to $5 million of the commitment to TicketsNow. As lead sponsor, Crisp led efforts to locate syndicate investors for the TicketsNow transaction.

15. The TicketsNow transaction closed in two tranches. The first tranche closed on or around January 19, 2007. Investors in the first tranche received promissory notes convertible to Series A Preferred Stock of TicketsNow. Three of Adams Street's funds – Adams Street V, L.P.; Adams Street 2006 Direct Fund, L.P.; and Adams Street 2007 Direct Fund, L.P. – invested a total of $9 million at that time. Adams Street did not syndicate any part of the first tranche. The second tranche closed on or around June 15, 2007. Investors in the second tranche received Series A Preferred Stock of TicketsNow.

16. Around the time of the closing of the first tranche, Crisp and Wolf discussed AV Partners investing in TicketsNow. On or around January 17, 2007, Crisp sent TicketsNow's investment summary to Wolf. On or around January 18, Crisp wrote in an email to a TicketsNow employee that AV Partners "will likely be in for $500,000 to $1 million" in the TicketsNow transaction.

17. By May 2007, however, Crisp had increased AV Partners's investment in the TicketsNow transaction by $500,000. On or around May 4, 2007, Crisp and Wolf decided that AV Partners would invest $1.5 million in the TicketsNow transaction – not the $500,000 to $1 million that Crisp previously represented. On or around May 14, Crisp sent an email to attorneys negotiating the

documents for the second closing stating that Adams Street "syndicated $2M of our $6M remaining investment in TicketsNow." (In addition to AV Partner's $1.5 million, Adams Street syndicated $500,000 to Croft & Bender, an entity familiar to Adams Street and suggested by the TicketsNow transaction co-sponsor.)

18. Crisp's May 16 email instructed that his increased syndication to AV Partners reduced *pro rata* the amounts invested in the TicketsNow transaction by Adams Street V, L.P.; Adams Street 2006 Direct Fund, L.P.; and Adams Street 2007 Direct Fund, L.P. Crisp lacked the authority to single-handedly change the agreed-upon syndication amount.

19. Crisp concealed his misappropriation of the investment opportunity in TicketsNow's securities, for AV Partners from Adams Street's funds, with intentional and reckless misrepresentations and omissions regarding at least four material facts:

a. First, Crisp concealed from Adams Street that he redirected the $500,000 opportunity from Adams Street's funds to AV Partners until two days before the closing of the second tranche. Then, Crisp lied about taking the opportunity for AV Partners. On June 13, 2007, Crisp sent the Adams Street deal co-sponsor documents indicating that Crisp syndicated a total of $2 million – not the previously-discussed and agreed upon $1.5 million – in the transaction. When asked about the discrepancy in the syndication amount by the co-sponsor, Crisp falsely replied that the co-sponsor was thinking of a different transaction. Crisp never revealed that he adjusted the syndication amount and that he and Wolf alone decided how much AV Partners would invest in the TicketsNow transaction.

b. Second, Crisp misrepresented to and concealed from Adams Street and TicketsNow Crisp's involvement with AV Partners, and the resulting conflicts of interest. On or around May 16, 2007, a TicketsNow employee asked Crisp "[w]ho are AV Partners?" Crisp falsely stated that "AV Partners is the investment vehicle of a friend." Adams Street's transaction co-sponsor also asked Crisp multiple times about AV Partners. Each time, Crisp falsely responded that AV Partners was Wolf's personal investment vehicle. Crisp described Wolf as a wealthy individual who set up his own investment vehicle to invest in venture backed companies. Crisp said that he was friendly with Wolf and that they had previously invested together. Moreover, as stated, Crisp failed to disclose AV Partners to Adams Street in the firm's required annual and quarterly disclosures.

c. Third, Crisp misrepresented to and concealed from Adams Street and TicketsNow that Crisp was motivated by personal profits and conflicting loyalties, not a purported prior commitment, when steering the investment opportunity to AV Partners. On or around May 16, 2007, a TicketsNow employee emailed that he was "surprised" by the increased allocation to AV Partners, and asked Crisp "[w]as this discussed before?" Crisp falsely responded that he "syndicated to both groups [AV Partners and Croft & Bender] right after we did the first close" in January 2007, "Im [*sic*] just honoring my word here." Likewise, in his June 13, 2007 email, Crisp falsely stated that he had committed AV Partners's investment amount "6 months ago right after the first close" and that "[n]ow that things are looking peachy, I wish I hadn't syndicated anything." Crisp thus falsely indicated that he had syndicated to AV Partners solely to satisfy a prior obligation, and that he was powerless to change it. In truth, on or around May 4, 2007, Crisp and Wolf decided that AV Partners would invest $1.5 million in TicketsNow, noting its "value." Also, in fact, Crisp was not honoring a prior commitment – Crisp personally profited more from AV Partners's investment than if Adams Street had invested in TicketsNow.

d. Fourth, on or around May 9, 2007, Crisp falsely represented and warranted to Adams Street that he was in compliance with Adams Street's Integrity Policy. Among other things, the Integrity Policy provided that employees, such as Crisp, obtain Adams Street's prior approval before investing in portfolio companies, such as TicketsNow. Crisp also hid that his conduct violated, and thus rendered false, similar provisions of Adams Street's limited partnership agreements for its funds – including for Adams Street V, L.P., Adams Street 2006 Direct Fund, L.P., and Adams Street 2007 Direct Fund, L.P – as well as other documents. Crisp was aware of these requirements, having sought approval in September 2006 for an unrelated transaction. And in another potential Adams Street transaction, Crisp recused himself from Adams Street's dealings with a company owned by his brother, and in which Crisp had an interest, because of the potential conflict of interest. Yet Crisp never sought or obtained prior approval for AV Partners's investment in TicketsNow.

20. Crisp's conduct also substantially assisted Adams Street's violations with respect to its funds.

21. In February 2008, another ticket broker company purchased TicketsNow by paying a specified amount of cash for each outstanding share of TicketsNow stock. TicketsNow's shareholders – including AV Partners and Adams Street's private equity funds – received almost four times their initial investment amount. AV Partners received approximately $5,749,808. This translated to a profit of $4,249,808 after Wolf was repaid his initial investment capital. Crisp personally received $2,124,904 – half of AV Partners's profits. The additional $500,000 investment that Crisp usurped from Adams Street for AV Partners resulted in profits (after Wolf was repaid his initial investment) of approximately $1,416,603, of which Crisp received $708,301.

22. Part of the TicketsNow buyout proceeds were held back in an escrow. This escrow money has now been distributed. Crisp is entitled to receive an additional distribution from the escrow funds in the amount of $89,761.

*Crisp Further Enriched Himself in the TicketsNow Buyout*

23. At the time of the TicketsNow buyout in February 2008, Crisp.served on the TicketsNow board of directors as Adams Street's representative. He acted as the firm's primary point of contact with TicketsNow.

24. On or about February 29, 2008, Crisp received a $150,000 "transaction bonus" from the TicketsNow closing money. TicketsNow's other outside directors did not receive similar payments. Indeed, when he learned that certain officers of TicketsNow were to receive bonuses, Crisp demanded that he too be paid a bonus for his contribution to the company. Crisp initially asked for a larger payment, but was negotiated down to $150,000. The payment reduced the amount that the company's shareholders – including Adams Street V, L.P.; Adams Street 2006 Direct Fund, L.P.; and Adams Street 2007 Direct Fund, L.P. – received from the buyout proceeds.

25. Crisp did not tell Adams Street or its funds that he requested, negotiated, and received this money. Crisp acted as Adams Street's primary point of contact throughout the buyout and handled virtually all communications with Adams Street's attorneys for the buyout. He instructed TicketsNow personnel to wire the money to his personal bank account – the same account in which Adams Street deposited Crisp's salary. After receiving the money, Crisp took no apparent steps to pay it to Adams Street before he was terminated on or about March 20, 2008.

26. Crisp knew, but ignored, that Adams Street's policies prohibit employees, like Crisp, from receiving personal payments in connection with Adams Street's transactions. And Crisp knew, but ignored, that the limited partnership agreements for Adams Street's funds promise that compensation paid to Adams Street partners, like Crisp, from a portfolio company "shall be remitted to the Management Company [Adams Street] and shall reduce the Management Fee" paid by the funds. Crisp's conduct rendered these representations to Adams Street's funds and investors false. Crisp's decision to ignore these provisions and to keep the money further demonstrates his fraudulent intent and substantial assistance of Adams Street's violations.

*Crisp's Deceit Secured a Second Investment Opportunity for AV Partners, and Crisp Tried to Arrange a Second Payout to AV Partners*

27. Between March and May 2007 – while Crisp was also syndicating the second tranche of the TicketsNow transaction – Adams Street committed certain of its private equity funds to invest $14 million in a travel company named Sherman's Travel. Adams Street anticipated syndicating up to $3 million of the committed amount. Crisp again served as lead sponsor for this transaction and the same Adams Street partner as in the TicketsNow transaction served as co-sponsor.

28. As lead sponsor on the Sherman's Travel transaction, Crisp met with Adams Street's Direct Investment Team to discuss the transaction, co-authored (with the deal co-sponsor) a memorandum recommending the investment to Adams Street's Investment Committee, and took the lead on otherwise communicating with Adams Street personnel about the transaction. The memorandum to the Investment Committee that Crisp co-authored advised about the company and the market sector, and recommended that Adams Street's funds invest in Sherman's Travel. The Investment Committee decided, as the Management Company and Managing Member of the General Partner, to invest Adams Street's funds' money in the Sherman's Travel transaction.

29. Crisp again syndicated $1 million of the stock investment opportunity to AV Partners. AV Partners continues to own its shares of Sherman's Travel. In their May 4, 2007 email exchange, Crisp and Wolf initially discussed investing $1.5 million in Sherman's Travel. Instead, Crisp and Wolf invested the extra $500,000 in TicketsNow, which ultimately proved to be the more lucrative opportunity.

30. Crisp again lied about his involvement with AV Partners in connection with the Sherman's Travel transaction. On May 4, 2007, a Sherman's Travel employee asked Crisp by email about AV Partners. Crisp falsely replied that AV Partners was Wolf's "'personal' investment vehicle, named after the first names of his kids."

31. In December 2007 and January 2008, a Sherman's Travel representative and Crisp exchanged ideas about raising additional capital for the company. Crisp proposed a payout to AV Partners while negotiating possible changes to Adams Street's funds' investment. Ultimately, the discussions did not culminate in a transaction.

*Adams Street Terminated Crisp and Crisp Admitted his Wrongdoing*

32. After discovering Crisp's misconduct and conducting an internal investigation, Adams Street terminated Crisp on or about March 20, 2008. Adams Street also self-reported the matter to the staff of the Commission. In or around May 2008, Crisp paid $2,274,903.86 to Adams Street, which equaled Crisp's half of AV Partners's payout from the TicketsNow transaction (except for the escrow funds recently received), plus his $150,000 merger compensation from the same deal. Crisp, through AV Partners, still holds the interest in Sherman's Travel. Crisp's repayment did not include $708,302 of AV Partners's profits (after Wolf was repaid his initial investment) from Crisp's increased syndication to it in the TicketsNow transaction.

33. During a phone call with one of Adams Street's partners after Crisp's termination in March 2008, Crisp admitted that his conduct was "clearly against Adams Street's policy, so I [Crisp] didn't tell you [the Adams Street partner]" about the conduct.

34. In or around January 2009, Crisp told an Adams Street partner in a telephone conversation that Crisp sought to raise investor money to start his own investment fund.

35. Crisp's actions described above made use of the mails and other means and instrumentalities of interstate commerce.

**Violations**

36. As a result of the conduct described above, Crisp willfully violated Sections 206(1), 206(2) and 206(4) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Rule 206(4)-8 promulgated thereunder, which prohibits fraudulent conduct by advisers to "pooled investment vehicles" with respect to investors or prospective investors in those pools.

37. As a result of the conduct described above, Crisp also willfully aided and abetted Adams Street's violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Rule 206(4)-8 promulgated thereunder, which prohibits fraudulent conduct by advisers to "pooled investment vehicles" with respect to investors or prospective investors in those pools.

38. As a result of the conduct described above, Crisp willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

## IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Crisp's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Crisp cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act, and Rule 206(4)-8 promulgated thereunder, and Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

B. Respondent Crisp be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and
>
> prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter,

with the right to apply for reentry after one (1) year to the appropriate self-regulatory organization, or if there is none, to the Commission.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall pay disgorgement of $89,761 to Adams Street Partners, LLC, One North Wacker Drive, Suite 2200, Chicago, Illinois 60603-2823 for distribution to the following funds: Adams Street V, L.P.; Adams Street 2006 Direct Fund, L.P.; and Adams Street 2007 Direct Fund, L.P. Respondent shall pay a civil penalty of $50,000 to the Securities and Exchange Commission. Payment shall be made as follows: the $89,761 disgorgement amount and the first $25,000 of the civil penalty are to be paid within 14 days from the date of this Order; the remaining $25,000 of the civil penalty, plus post-Order interest, is to be paid within 365 days of the date of this Order. If any payment is not made by the dates required by this Order, the entire outstanding balance of disgorgement and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payments to the Commission must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Matthew Crisp as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Timothy L. Warren, Division of Enforcement, Securities and Exchange Commission, 175 West Jackson Blvd., Suite 900, Chicago, IL 60604.

E. Such civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Chairman Schapiro
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9355 / August 31, 2012

SECURITIES EXCHANGE ACT OF 1934
Release No. 67768 / August 31, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3452 / August 31, 2012

INVESTMENT COMPANY ACT OF 1940
Release No. 30189 / August 31, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15002

| | |
|---|---|
| In the Matter of<br><br>Jay T. Comeaux<br><br>Respondent. | ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER, AND NOTICE OF HEARING |

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Jay T. Comeaux ("Comeaux" or "Respondent").

## II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, and Notice of Hearing ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

### Respondent

1. Respondent Jay T. Comeaux (CRD # 1617778) was President of Stanford Group Company ("SGC"), a Houston-based broker-dealer and investment adviser registered with the Commission, from January 1996 until March 2005. Between March 2005 and February 2009, Comeaux was Executive Director of SGC. As Executive Director, Comeaux managed SGC's Houston branch office. Comeaux was also a registered representative/advisory representative of SGC. Before joining SGC, Comeaux worked for nine years at another brokerage in Baton Rouge, LA. Comeaux is 64 years old and lives in Houston, Texas. During the relevant time period, Comeaux held Series 3, 7, 24, 53, 63, and 65 licenses.

### Other Relevant Entities

2. SGC was a broker-dealer and investment adviser registered with the Commission. SGC was a wholly-owned subsidiary of Stanford Group Holdings, Inc., which in turn was owned and controlled by Robert Allen Stanford ("Allen Stanford").

3. Stanford International Bank ("SIB") was a private international bank domiciled in St. John's, Antigua and Barbuda. SIB was owned and controlled by Allen Stanford. By 2008, SIB claimed to serve as many as 30,000 clients in 130 countries and to have approximately $8 billion in assets under management. SGC's business included sales of SIB certificates of deposit (the "SIB CDs"). Throughout Comeaux's tenure with SGC, sales of SIB CDs generated more than half of

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement. These findings are solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party. The findings herein are not binding on any other person or entity in this or any other proceeding.

SGC's total revenues. In 2007 and 2008, SGC financial advisers sold over $2 billion in SIB CDs, primarily to U.S. investors.

## Facts

### *Comeaux's Relationship with Stanford*

4. While associated with his former firm, Comeaux managed a portfolio of funds for SIB's predecessor, Guardian International Bank.

5. In January 1996, Comeaux left his former firm and joined SGC as President. SGC designated Comeaux as the person responsible for "overall supervision of all financial consultants." SGC referred to its employees who handled advisory clients and brokerage customers as "financial advisers" or "financial consultants" (hereinafter the "FAs"). FAs, including Comeaux, recommended and sold SIB CDs to brokerage customers and, in other instances, recommended to advisory clients portfolio allocation products that included SIB CDs. The SIB CD purchasers were often risk-averse investors.

6. Between 1998 and 2009, Comeaux recommended and sold SIB CDs. Comeaux received commissions of at least $1.3 million on the sales of the SIB CDs. He also received bonuses and other compensation based on the revenues of the Houston branch.

### *Liquidity of SIB's Investment Holdings*

7. Beginning in October 1998, SGC FAs, including Comeaux, offered and sold SIB CDs to U.S. investors pursuant to a private placement exemption from registration under Regulation D of the federal securities laws. SGC and its FAs, including Comeaux, received significant revenue as a result of recommending the SIB CD to their clients. Comeaux knew that this revenue constituted a substantial portion of SGC's overall revenue during his tenure.

8. SGC trained its FAs, including Comeaux, to tell investors that SIB's portfolio of assets was highly marketable and liquid. However, Comeaux knew that SIB would not disclose the details of its investment holdings to him or other SGC executives or representatives. Despite knowing that SIB's investment portfolio was not transparent to SGC, SGC and Comeaux used promotional marketing material to represent to investors that SIB maintained a "well-diversified portfolio of highly marketable securities issued by stable governments, strong multi-national companies and major international banks."

9. The liquidity of SIB's underlying portfolio was a material feature of SIB's and SGC's marketing of SIB CDs.

10. SIB's portfolio was not invested in highly marketable and liquid assets. Other than his reliance on SIB's representations, Comeaux and other SGC FAs had no basis in fact to make such a representation to investors.

*Comprehensive Insurance Program*

11. The FAs, including Comeaux, understood that in contrast to certificates of deposit issued by U.S. banks, the SIB CDs were not insured. SGC and Comeaux, however, marketed and sold the SIB CDs using a brochure that discussed the SIB CD to represent to investors that SIB maintained a "comprehensive insurance program" that provided "depositor security."

12. SGC also used training material for SGC FAs, including Comeaux, claiming that (a) SIB maintained a comprehensive insurance program that protected investors; (b) FDIC insurance was "relatively weak" in comparison to SIB's insurance program; and (c) SIB was subject to an extensive risk management analysis conducted by an outside firm to determine whether reasonable care is routinely exercised in the protection of the bank's assets.

13. The alleged "comprehensive insurance program" was a material feature of SIB's and SGC's marketing of SIB CDs.

14. SIB did not maintain a "comprehensive insurance program" that provided depositor security, and had no insurance program that was the equivalent of — or better than — that provided by the FDIC. Further, SIB was not subject to an extensive risk management analysis by an outside firm to determine whether reasonable care is routinely exercised in the protection of the bank's assets. Comeaux knew that SIB CDs were not covered by a "comprehensive insurance program."

**Violations**

15. The representations described above were materially false and misleading.

16. Comeaux and the SGC FAs he supervised owed a duty of fair dealing to their customers. Because they could not confirm SIB's representations regarding the safety of the SIB CD and the liquidity of SIB's investment portfolio, SGC, Comeaux, and the SGC FAs he supervised did not have a reasonable basis to recommend SIB CDs to investors.

17. When Comeaux and the other SGC FAs provided investment advice to their clients in connection with recommending SIB CDs and other investments, they owed their clients a duty to exercise the utmost good faith in dealing with clients, a duty to disclose all material facts, a duty to employ reasonable care to avoid misleading clients, and a duty to disclose all material, actual or potential conflicts of interest. By failing to fully disclose SGC's and their own financial interest in selling the SIB CDs, SGC, Comeaux, and SGC's FAs failed to disclose material conflicts of interest.

18. As a result of the conduct described above, SGC, SIB, and Comeaux willfully violated and Comeaux willfully aided and abetted and caused SGC's and SIB's violations of Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of

securities. SGC and SIB also willfully violated and Comeaux willfully aided and abetted and caused SGC's and SIB's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the purchase or sale of securities. Furthermore, SGC violated and Comeaux willfully aided and abetted and caused SGC's violations of Sections 206(1) and 206(2) of the Advisers Act, which make it unlawful for an adviser to employ any device, scheme or artifice to defraud any client or prospective client or to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

**IV.**

Respondent undertakes to the following: In connection with this action and any related judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party, Respondent (i) agrees to appear and be interviewed by Commission staff at such times and places as the staff requests upon reasonable notice; (ii) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; (iii) appoints Respondent's undersigned attorney as agent to receive service of such notices and subpoenas; and (iv) consents to personal jurisdiction over Respondent in any United States District Court for purposes of enforcing any such subpoena.

**V.**

Pursuant to this Order, Respondent agrees to additional proceedings in this proceeding to determine what, if any, disgorgement and civil penalties pursuant to Section 8A(e) of the Securities Act, Section 21B of the Exchange Act, Sections 203(i) and 203(j) of the Advisers Act and Section 9(d) of the Investment Company Act against Respondent is in the public interest. In connection with such additional proceedings: (a) Respondent agrees the he will be precluded from arguing that he did not violate the federal securities laws described in this Order; (b) Respondent agrees that he may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the allegations of the Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence. To the extent that any of Respondent's assets are subject to the control of the court-appointed receiver in *SEC v. Stanford,* those assets, the value of which will be determined at the time of entry of a final order in this matter, will be credited against any monetary sanctions ordered against Respondent in this matter.

**VI.**

In view of the foregoing, the Commission deems it appropriate in the public interest to impose the sanctions agreed to in the Offer, and to institute proceedings to determine what, if any, disgorgement and civil penalties are appropriate.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Comeaux shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act;

B. Respondent Comeaux shall be, and hereby is, barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization; prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

## VII.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section V hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

If Respondent fails to appear at a hearing after being duly notified, Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice, 17 C.F.R. § 201.360(a)(2).

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67773 / August 31, 2012**

**INVESTMENT ADVISERS ACT OF 1940**
**Release No. 3455 / August 31, 2012**

**INVESTMENT COMPANY ACT OF 1940**
**Release No. 30192 / August 31, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-15004**

**In the Matter of**

**JASON A. D'AMATO,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, AND NOTICE OF HEARING**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Jason A. D'Amato ("Respondent" or "D'Amato").

## II.

After an investigation, the Division of Enforcement alleges that:

### A. RESPONDENT

1. D'Amato is 38 years old and lives in Katy, Texas. From May 2003 through February 2009, D'Amato served in various roles for Stanford Group Company ("SGC") and Stanford Capital Management, L.L.C. ("SCM"), including: (i) President of SCM (Sep. 2008 – Feb. 2009); (ii) Senior Investment Officer of SCM (Dec. 2007 – Sep. 2008); (iii) Director of the Investment Advisory Group at SCM (Sep. 2006 – Dec. 2007) and at SGC (Nov. 2005 – Sep. 2006); and (iv) Assistant Analyst in SGC's Investment Advisory Group (May 2003 – Nov. 2005). From November 2005 through at least September 2008, D'Amato managed a proprietary mutual fund wrap program called Stanford Allocation Strategies ("SAS") for SCM and SGC. During this time, D'Amato made all investment decisions for each of the program's strategies (income, balanced income, balanced, balanced growth, and growth). Currently, D'Amato works as: (i) the Chief Investment Officer of a Houston, Texas-based investment adviser registered with the State of Texas; (ii) a registered representative of a Houston, Texas-based broker-dealer registered with the Commission; and (iii) an affiliated person of a Houston, Texas-based investment adviser registered with the Commission.

### B. OTHER RELEVANT ENTITIES

2. Stanford Capital Management, L.L.C., a Delaware limited liability company, was an investment adviser registered with the Commission from September 2006 through September 2009. On February 17, 2009, U.S. District Judge Reed O'Connor appointed a receiver to take control of and manage SCM. As of its last pre-receivership filing with the Commission, SCM had nearly $1.7 billion in assets under management. SCM executed a sub-advisory agreement with SGC, pursuant to which it provided investment advice for the investment products offered and sold by SGC, including SAS.

3. Stanford Group Company, a Texas corporation headquartered in Houston, Texas, has been dually-registered with the Commission as a broker-dealer and investment adviser since October 1995. As of February 1, 2012, SGC was still registered with the Commission, as the Receiver continues to wind down its business. SGC's principal business consisted primarily of sales of Stanford International Bank-issued securities (self-styled as certificates of deposit) and the SAS mutual fund wrap program managed by SCM. SAS clients contracted directly with SGC.

### C. HISTORY OF SAS PROGRAM

4. In 2000, SGC began offering a mutual fund allocation program known as Mutual Fund Partners ("MFP") through its Investment Advisory Group ("IAG"). MFP offered several different strategies depending on an investor's risk threshold and investment objectives, which were determined based on an investor's responses to a

questionnaire. Throughout the history of the program, there were as many as 10 and as few as five different strategies/allocations, including income, balanced income, balanced, balanced growth, and growth.

5. In May 2003, SGC hired D'Amato as an assistant analyst in IAG to, among other things, track and calculate the performance of each MFP strategy and create personalized proposals ("Pitchbooks") for SGC financial advisers ("FAs") to use in one-on-one presentations to prospective clients. The substance and length of the Pitchbooks evolved over time, but nearly every version contained several charts showing the performance of each strategy dating back to 2000. The charts were variously labeled "Hypothetical Performance," "Hypothetical Historical Performance," or "Model Performance." Regardless of the label, the actual data in the Pitchbooks remained consistent.

6. In or around September 2004, D'Amato calculated the performance returns for each MFP strategy by backtesting existing allocations against historical data for the previous five years (i.e., if a client held the September 2004 allocation back in 2000, this is how it would have performed). IAG presented these model returns in Pitchbook charts and compared them to the S&P 500 returns for the same time period. As shown below for the period of 2000 to 2005, the backtested models consistently outperformed the S&P 500 by an overwhelming percentage:

**Calendar Year Return**

| | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|---|
| **SAS Growth** | 12.09% | 16.15% | 32.84% | -3.33% | 4.32% | 18.04% |
| **S&P 500** | 4.91% | 10.88% | 28.68% | -22.10% | -11.88% | -9.11% |

7. In November 2005, D'Amato became the Director of IAG and MFP's portfolio manager. In March 2006, IAG changed the name of the program from MFP to Stanford Allocation Strategies. In September 2006, IAG separated from SGC and formed Stanford Capital Management. D'Amato continued to manage the SAS program and make investment decisions for each of the program's portfolios.

8. In or around October 2006, several SGC FAs expressed "serious concerns" to SCM's senior management about the performance returns presented in SAS Pitchbooks. The FAs complained that *none* of their clients had achieved the returns that SCM touted. As a result, SCM hired a performance reporting consultant to identify the disconnect between the returns presented in the Pitchbooks and the returns achieved in actual SAS accounts. For at least 2005 and 2006, the consultant concluded that: (i) actual returns earned by SAS clients were, in most cases, hundreds of basis points lower than the returns advertised in the Pitchbooks, and (ii) D'Amato and his team of analysts did not keep records to show contemporaneous changes in each of SAS's strategies prior to 2005, so the consultant could not verify the pre-2005 numbers.

9. Despite the consultant's findings, some SCM senior managers and SGC FAs wanted to continue using previously published performance data for 2000

through 2004 so they could show a seven-year track record for the SAS program. While performance data for 2000 through 2004 could not be verified, SCM management chose to continue using those figures in the Pitchbooks. At a meeting in March 2007, SGC's Executive Director and several SGC FAs learned from SCM senior management that SAS Pitchbooks would include unverified performance data for 2000 through 2004 directly alongside audited, composite performance data for 2005 and later years. By the end of May 2007, SGC began distributing Pitchbooks, prepared by SCM, to prospective SAS clients that contained these divergent sets of performance data and that included the following end-of-Pitchbook disclosure (the "SAS Model Performance Disclosures"):

> The SAS Composite for the Income, Balanced Income, Balanced, Balanced Growth, Growth, and Equity/Alternative strategies have been audited and verified by [consultant's entity] from first quarter 2005. Previous performance figures have not been audited and SCM does not represent that this information is accurate, current, or complete and it should not be relied upon as such.

10. Notwithstanding the disclosure, the revised Pitchbooks were deficient in several significant respects.

i. SGC could not locate any records to support the advertised performance data for 2000 through 2004. SCM did not disclose this fact in the Pitchbooks.

ii. The label used to describe the data was changed from "Hypothetical" to "Historical" performance. This label was inaccurate and misleading because the term "historical" performance suggested actual performance by SAS clients and gave the impression that the performance data represented actual performance. In fact, the 2000 to 2004 performance data was based upon backtesting, while the 2005 to 2008 data represented audited, composite data that accurately reflected returns earned by actual SAS clients.

iii. The unaudited/unverified performance data from 2000 to 2004 was blended with actual performance data from 2005 to 2008 to create five-year, seven-year, and since inception annualized returns. This misleading performance data was reported alongside actual year-to-date, 1-year, 3-year, 5-year, 7-year, and since inception performance information – without any explanation that the data included in the 5-year, 7-year, and since inception periods actually represented a blend of hypothetical performance data with actual data. These 5-year, 7-year, and since inception annualized returns were inflated because the data for 2000 to 2004 materially skewed the overall performance. For example, in a 2008 Pitchbook, SCM presented SAS results in the following manner:

**Annualized Returns**
**(not annualized if less than one year)**

| | YTD | 1 year | 3 years | 5 years | 7 years | Since inception |
|---|---|---|---|---|---|---|
| **SAS Growth** | -7.44% | 0.80% | 9.36% | 15.31% | 11.03% | 12.30% |
| **S&P 500** | -9.44% | -5.08% | 5.85% | 11.32% | 3.70% | 2.45% |

11. D'Amato knew that:

i. the 2000 to 2004 performance data for the SAS program was calculated differently than the 2005 to 2008 data;

ii. labeling the blended data as "historical performance" was misleading;

iii. SAS performance history was material to an FA's clients; and

iv. the advertised 2000 to 2004 returns were not realistic because of how they were tracked.

12. D'Amato frequently participated in presentations to clients and prospective clients (as well as to FAs that were being recruited to join SGC). After May 2007, D'Amato created and used Pitchbooks (and Recruit Packets for the FA recruits) that contained "Historical Performance" figures for the SAS program that merged and blended audited, composite returns for 2005 and subsequent years with hypothetical, backtested returns for 2000 through 2004. The Pitchbooks also contained the incomplete and misleading SAS Model Performance Disclosures.

13. D'Amato, as a representative of registered investment advisers (SGC and SCM) who recommended advisory products – like SAS – to clients for a fee, owed a duty to exercise the utmost good faith in dealing with clients, a duty to disclose all material facts, a duty to employ reasonable care to avoid misleading clients, and a duty to disclose all conflicts of interest.

14. D'Amato did not disclose to clients, prospective clients, and SGC FAs that the performance data presented in the Pitchbooks was: (i) a combination of hypothetical, backtested data and audited, composite numbers; and (ii) not accurately labeled as "historical performance." Further, D'Amato omitted to disclose that SCM could not locate records to support the advertised SAS performance numbers for 2000 through 2004.

## D. D'AMATO MISREPRESENTED HIS CREDENTIALS

15. At least as early as February 2005, D'Amato began misrepresenting himself to co-workers, clients, prospective clients, SGC FAs, and prospective FAs as a Chartered Financial Analyst ("CFA").[1]

16. D'Amato was not, and has never been, a CFA charterholder. Nonetheless, D'Amato used the CFA designation in his e-mail signature block on thousands of e-mails and on his business cards. To perpetuate this lie, D'Amato fabricated an e-mail that he purportedly received from the CFA Institute that congratulated him on passing the Level III CFA exam and achieving charterholder status. In fact, D'Amato failed the CFA Level I exam the first and only time he took it.

17. D'Amato passed along his fabricated e-mail to SGC's Human Resources department, who in turn passed it along to SGC's compliance department. SGC and SCM – the entities that employed D'Amato before and after September 2006 respectively – failed to verify D'Amato's credentials by, for example, contacting the CFA Institute or checking the public membership directory on the CFA Institute website. Instead, based solely on D'Amato's misrepresentations and his fabricated e-mail, SGC and SCM actively promoted and marketed D'Amato as a CFA to prospective and existing clients and FAs, as follows:

i. listing D'Amato as a CFA charterholder in his bio on their websites;

ii. furnishing copies of D'Amato's bio to SGC FAs to provide to prospective and existing clients to introduce them to D'Amato and to tout his qualifications;

iii. routinely including a copy of D'Amato's bio in formal responses to Requests for Proposal ("RFPs") from larger investors like institutions, endowments, and foundations;

iv. representing D'Amato as a CFA charterholder on Schedule H of various iterations of SCM's Form ADV Part IIs from December 28, 2007 to August 28, 2008; and

v. presenting D'Amato as a CFA charterholder in the various presentations and pitches to prospective clients and FAs in which he was involved.

18. In a span of five years, D'Amato ascended from the role of assistant analyst to President of SCM. In announcing D'Amato's promotion to SCM President, SGC's President credited D'Amato with: (i) increasing assets under management ("AUM")

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[1] The CFA charter is conferred upon a candidate by the CFA Institute after the candidate passes three exams: Level I, Level II, and Level III. A CFA candidate cannot take the Level III exam without first passing the Levels I and II exams.

in SAS from less than $10 million in 2004 to $1.2 *billion* by the end of 2008, and (ii) generating $25 million in SAS management fees in 2007 and 2008 alone.

19. D'Amato's compensation structure was tied to: (i) AUM in the advisory programs that he managed, including SAS, and (ii) the amount of management fees that SGC and SCM derived therefrom. As the AUM in SAS increased exponentially from 2004 to 2008, the percentage of D'Amato's overall compensation attributable to bonuses rose accordingly. D'Amato derived more than 50 percent of his total compensation from bonuses in 2007 and 2008, and his total compensation nearly quadrupled from 2005 to 2008.

**D'Amato Compensation**

| | **2004** | **2005** | **2006** | **2007** | **2008** |
|---|---|---|---|---|---|
| **Gross Pay** | $88,789 | $113,930 | $219,055 | $344,913 | $425,000 |
| **Salary (% of Gross Pay)** | $63,750 (72%) | $78,333 (69%) | $120,000 (55%) | $141,250 (41%) | $187,500 (44%) |
| **Bonus (% of Gross Pay)** | $25,039 (28%) | $35,596 (31%) | $99,056 (45%) | $203,664 (59%) | $237,500 (56%) |

E. VIOLATIONS

20. As a result of the conduct described above, D'Amato willfully violated and willfully aided and abetted and caused SGC's violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

21. As a result of the conduct described above, D'Amato willfully aided and abetted and caused SGC's violations of Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser.

22. As a result of the conduct described above, D'Amato willfully aided and abetted and caused SCM's violations of Section 207 of the Advisers Act, which requires that filings by advisers be accurate when filed with the Commission and prohibits any untrue statement of a material fact in any registration application or report.

## III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford D'Amato an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against D'Amato pursuant to Section 15(b) and 21C of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against D'Amato pursuant to Sections 203(f) and 203(k) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203(i) of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against D'Amato pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9(d) of the Investment Company Act;

E. Whether, pursuant to 21C of the Exchange Act and Section 203(k) of the Advisers Act of the Investment Company Act, D'Amato should be ordered to cease and desist from committing or causing violations of and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 207 of the Advisers Act, and whether D'Amato should be ordered to pay disgorgement pursuant to Section 21C(e) of the Exchange Act.

## IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro not participating

**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**
**Release No. 9356 / August 31, 2012**

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67769 / August 31, 2012**

**INVESTMENT ADVISERS ACT OF 1940**
**Release No. 3453 / August 31, 2012**

**INVESTMENT COMPANY ACT OF 1940**
**Release No. 30190 / August 31, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-15003**

| | |
|---|---|
| **In the Matter of**<br><br>**DANIEL BOGAR,**<br>**BERNERD E. YOUNG, and**<br>**JASON T. GREEN**<br><br>**Respondents.** | **ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940** |

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Daniel Bogar ("Bogar"), Bernerd E. Young ("Young"), and Jason T. Green ("Green")(collectively, the "Respondents").

**II.**

After an investigation, the Division of Enforcement alleges that:

## Respondents

1. Between March 2005 and February 2009, Bogar (CRD #4819578) was President of: (i) Stanford Group Company ("SGC"), a Houston-based broker-dealer and investment adviser registered with the Commission, and (ii) Stanford Group Holdings ("SGH"), SGC's parent company. From 2000 to 2005, Bogar oversaw SGC's merchant banking group, managing the private equity investments of Stanford International Bank Ltd.'s ("SIB") investment portfolio. Bogar is 53 years old, unemployed, and lives in Fort Lauderdale, Florida. Bogar holds Series 7, 24, and 66 licenses.

2. Between July 2006 and February 2009, Young (CRD #1109172) was Managing Director of Compliance and Chief Compliance Officer ("CCO") of SGC and SGH. From January 1984 to May 2003, Young worked for the National Association of Securities Dealers, now known as the Financial Industry Regulatory Authority ("FINRA"), most recently as the District Director of its Dallas office. Since terminating his association with SGC, Young has been the Chief Executive Officer of a securities-consulting company based in The Woodlands, Texas, which advises regulated entities about compliance with the federal securities laws. Young is 53 years old and lives in Fullshear, Texas.

3. Between February 1996 and February 2009, Green (CRD #2066514) was employed by SGC. Within SGC, Green served as: Senior Vice President, Financial Planning (February 1996 to April 2001); Senior Managing Director (April 2001 to January 2007); and President, Private Client Group, reporting to Bogar (January 2007 to February 2009). Green is 49 years old, unemployed, and lives in Baton Rouge, Louisiana. Green holds Series 4, 7, 24, 53, 63, and 65 licenses.

## Other Relevant Entities

4. SGC is a Houston-based corporation that has been dually registered with the Commission as a broker-dealer and investment adviser since October 1995. SGC was a wholly-owned subsidiary of SGH, which was owned and controlled by Robert Allen Stanford ("Allen Stanford"). SGC and SGH are currently in receivership.

5. SIB is a private international bank organized under the laws of Antigua and Barbuda. SIB was owned and controlled by Allen Stanford. By 2008, SIB claimed to serve as many as 30,000 clients in 130 countries and to have approximately $7.2 billion in deposits and $8 billion in assets. SGC's business included sales of certificates of deposit issued by SIB (the "SIB CDs"). SIB is currently in receivership.

## **Facts**

*Background*

6. Since at least 1990, SIB promoted itself as an international bank that provided private banking services. SIB was not a commercial bank and did not engage in traditional banking activities. It operated for the sole purpose of selling its self-styled CDs.

7. Beginning in 1998, SIB offered and sold its CDs to U.S. investors exclusively through its affiliate SGC and its associated financial advisers ("FAs"), pursuant to Regulation D of the Securities Act of 1933. SIB and SGC used a disclosure statement and a sales brochure (collectively the "offering documents") to facilitate the offer and sale of SIB CDs in the U.S. SIB prepared the offering documents; however, in 2007, Young modified the offering documents in an effort to comply with FINRA's advertising standards, and began affixing SGC's name to the sales brochure.

8. SGC FAs recommended and sold the CDs to brokerage customers and, in other instances, recommended the SIB CDs to advisory clients as either: (i) a component of recommended portfolio allocations, or (ii) an embedded part of a proprietary advisory product.[1] SGC clients frequently liquidated existing securities holdings in order to purchase the SIB CDs that were recommended to them by SGC FAs.

9. SIB and SGC emphasized a number of features that purportedly made the SIB CDs safe and secure for investors. SIB and SGC represented that investor funds would be pooled and invested in a well-diversified portfolio of highly marketable and liquid securities issued by stable governments, strong multi-national companies, and major international banks, and managed by an international network of experienced money managers following a conservative investment philosophy; that SIB maintained a "comprehensive insurance program," including "excess FDIC" coverage and other policies issued by Lloyd's of London, that provided "depositor security;" and that the returns generated from SIB's investment portfolio would be used to pay the promised yields.

10. In reality, SIB was an elaborate Ponzi scheme run by its sole shareholder, Allen Stanford, and a handful of his closest confidants. The advertised returns of SIB's underlying investment portfolio were fabricated at Allen Stanford's direction. SIB's investment portfolio consisted largely of illiquid private equity investments in obscure companies, massive real estate holdings in Antigua and the Caribbean, and undisclosed loans to Allen Stanford. SIB also used investor funds to make Ponzi payments to investors and to finance the operations of other Stanford affiliates, including SGC. Additionally, SIB had no insurance that protected CD investors.

11. On February 17, 2009, the Commission filed a complaint against SIB, SGC, Allen Stanford, and others, alleging that the defendants engaged in an $8 billion fraudulent scheme that was principally funded by sales of the SIB CD.

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1 As a general matter, SGC never made any distinction between advisory and brokerage products or services.

12. On June 18, 2009, criminal fraud charges were filed against Allen Stanford, James Davis ("Davis") (Chief Financial Officer of Stanford Financial Group), and others, for their roles in the alleged scheme. On August 29, 2009, Davis entered a plea agreement in which he acknowledged that "approximately 80% of SIB's investment portfolio was made up of illiquid investments, including grossly overvalued real and personal property that SIB had acquired from Stanford-controlled entities at falsely inflated prices." Further, Davis acknowledged that at least $2 billion "of undisclosed, unsecured personal loans from SIB to Stanford were concealed and disguised in SIB's financial statements as 'investments.'" On March 6, 2012, a jury convicted Allen Stanford of numerous criminal charges for his role in the fraud. On June 14, 2012, Allen Stanford was sentenced to 110 years in prison.

*The Respondents Mandated the Use of Misleading and Incomplete Offering Documents*

13. Bogar, Young and Green took several trips to Antigua to investigate and perform due diligence on SIB. In connection with these trips, the Respondents reviewed SIB's annual reports, quarterly market recap reports, and the offering documents used by SGC to market SIB's CDs to U.S. investors. The Respondents also toured SIB's facilities and participated in meetings chaired by SIB executives. During these meetings, bank officials showed the Respondents PowerPoint presentations about the history of Antigua, general operations of the bank, the Antiguan regulatory process, and the investment parameters that SIB purportedly used to manage its portfolio.

14. Through the due diligence process and otherwise during the course of their employment with SGC, the Respondents knew that SIB and SGC made certain representations about key components of the CD program in the offering documents:

(a) SIB and SGC represented that "liquidity" was a key feature of SIB's investment portfolio: "We focus on maintaining the highest degree of liquidity as a protective factor for our depositors. The Bank's assets are invested in a well-diversified portfolio of highly marketable securities issued by stable governments, strong multinational companies and major international banks." Further, SIB claimed that it had averaged double-digit returns on its investments for more than 15 years;

(b) SIB and SGC represented that SIB maintained a "comprehensive insurance program" that provided "depositor security";

(c) SIB and SGC represented that SIB paid SGC a 3% fee for marketing the CDs to potential investors;

(d) SIB and SGC represented that SIB had entered into certain "affiliate transactions" with SGC; and

(e) SIB and SGC represented that SIB had audited financial statements prepared by C.A.S. Hewlett & Co.

15. Young and Green spearheaded SGC's mandatory training program to reinforce the key components of SIB's CD program. In connection with the training program, Green and Young distributed a Training Manual that provided a guide for promoting the SIB CD to U.S. investors. Green and Young required SGC FAs to use the offering documents in connection with the offer and sale of SIB CDs to U.S. investors.

16. Among other things, the training manual emphasized the importance of liquidity as a safety and security feature of the SIB CD. For example, the training manual claimed that liquidity was "an excellent security factor" because, as SIB claimed, its liquid assets exceeded its liabilities.

17. Additionally, the training manual claimed that FDIC insurance "provide[d] relatively weak protection" in comparison to SIB's "comprehensive insurance program," which included policies issued by Lloyds of London. To secure the policies, SIB claimed it was subject to an extensive risk management analysis to determine whether reasonable care was routinely exercised to protect its assets. The training manual boasted that SIB was "probably the only offshore bank in the world with this type of coverage."

18. As a result of their investigation of SIB and the CD program:

(a) The Respondents knew that SIB refused to allow SGC to review and confirm SIB's investment portfolio, including its historical performance and advertised liquidity. The Respondents, however, failed to require SGC to disclose that SGC was unable to confirm SIB's representations about the investment portfolio underlying the SIB CD, including portfolio performance and liquidity;

(b) The Respondents knew that SIB did not maintain any private insurance that protected depositors. And Young knew or was reckless in not knowing that SIB was not subject to an extensive risk management analysis;

(c) Bogar and Young knew or were reckless in not knowing that SIB paid SGC at least six times the stated referral fee, and that SIB and SGC failed to disclose that: (i) SGC managed SIB's private equity investments; and (ii) SGC-associated analysts managed and monitored a portion of SIB's equity portfolio and produced research reports, including asset allocation adjustments, on behalf of SIB. As Bogar and Young were aware, these undisclosed affiliated transactions generated significant revenue for SGC, which also was not disclosed to SGC's customers who invested in SIB CDs; and

(d) The Respondents knew that SGC FAs had long-standing concerns about SIB's little-known Antiguan auditor and that the FAs repeatedly requested that SIB engage a more reputable audit firm.

19. Nonetheless, Bogar and Young reviewed and approved the offering documents and training material for use by SGC in marketing the SIB CD to U.S. investors. And Young and Green, through the mandatory training program, armed SGC FAs with misleading information that Young and Green knew would reach U.S. investors.

*The Respondents Incentivized SGC FA's to Push SIB's CDs*

20. In or around 2003, Allen Stanford demanded that SGC raise money for SIB through the sale of CDs. As part of this effort, Allen Stanford instituted international sales contests designed exclusively to grow SIB CD sales. The SGC team—the "Superstars"—competed against international teams with names such as "Money Machine" and "Deal Hunters." Allen Stanford appointed Green the "Captain" of the Superstars. Sales by individual FAs and by teams were tracked using a spreadsheet called the "Scorecard" or the "Hustle Sheet," which was distributed by Green throughout SGC on a regular basis. Bogar and Young regularly received these spreadsheets that tracked total CD sales. SGC did not offer sales contests that encouraged or incentivized the sales of any other products.

21. Additionally, as part of SGC's mandatory CD training program, Green developed, and Young approved, a model that authorized SGC FAs to allocate a significant portion of their clients' portfolio (as much as 50% for conservative, income investors) to the SIB CD.

22. SIB provided SGC and its FAs significant financial incentives to sell the SIB CDs. SGC FAs who sold the SIB CD received: (i) one percent upon the sale, (ii) a trailing commission of one percent for each year of the CD's term, and (iii) additional quarterly bonuses based on the total volume of SIB CDs sold. By February 2008, an outside consultant advised SGC executives, including the Respondents, that SGC's compensation program was above market and resulted in "distorted" focus on the sale of the SIB CD.

23. The sales contests, model allocations and commission structure accomplished the intended effect: sales of SIB CDs grew each year from 2005 through 2008. Sales by SGC FAs accounted for 44% of worldwide SIB CD sales in 2007 and 48% in 2008.

24. The Respondents also received significant compensation, largely as a result of SIB's success in growing its revenues through SIB CD sales. Bogar earned approximately $4 million during his tenure as SGC President. Young earned approximately $1 million during his tenure as SGC CCO. Green earned over $7 million—including $3 million in bonuses for meeting targeted SIB CD sales goals as part of the sales contests and $761,375 in SIB CD commissions.

*SGC Was Financially Dependent on SIB*

25. SGC depended on the revenues it derived from sales of SIB CDs, managing portions of its portfolio, and annual capital contributions from Allen Stanford. From 2004 to 2008, SGC received: (i) approximately $360 million from SIB in connection with the sale of SIB CDs; and (ii) more than $93 million for managing SIB's undisclosed private equity investments and for preparing its quarterly research reports. In total, almost 58% of SGC total revenues during this time derived from its relationship with SIB.

26. But even this revenue was not sufficient to sustain SGC—it received additional contributions of $175 million from Allen Stanford to maintain its operations. Other than

suggesting that SGC only received a one-time 3% fee for selling the SIB CDs, neither SGC nor SIB disclosed SGC's financial dependence on SIB and Allen Stanford:

| Year to Date | Total Revenue | SIB CD Sales | Private Equity Agreement | Research Fees | % of Revenue |
|---|---|---|---|---|---|
| 12/31/2004 | 65,434,199 | 42,925,466 | 3,957,439 | | 71.65% |
| 12/31/2005 | 97,775,729 | 56,786,492 | 5,420,170 | | 63.62% |
| 12/31/2006 | 171,477,685 | 88,116,507 | 7,368,181 | 16,000,000 | 65.01% |
| 12/31/2007 | 204,435,328 | 77,786,218 | 8,200,633 | 17,000,000 | 50.38% |
| 12/31/2008 | 245,804,348 | 94,523,080 | 13,738,259 | 21,600,000 | 52.83% |
| **Total** | **784,927,289** | **360,137,763** | **38,684,682** | **54,600,000** | **57.77%** |

| SGC Net Income/(Loss) | Capital Contributions |
|---|---|
| (3,628,184) | 10,000,000 |
| (19,866,431) | 21,000,000 |
| (20,509,297) | 51,500,000 |
| (27,384,103) | 41,750,000 |
| (22,752,483) | 51,000,000 |
| **(94,140,498)** | **175,250,000** |

27. SGC failed to disclose the extent of its financial relationship with SIB and, with respect to advisory clients, the conflicts of interest attendant to its relationship with SIB.

*Green Made and Used Misleading Statements Regarding the Safety and Security of the SIB CD*

28. Green sold millions of dollars of SIB CDs in his capacity as an FA. Green used the misleading offering documents when marketing the SIB CD to U.S. investors. Green knew or was reckless in not knowing that the offering documents contained misleading or incomplete statements regarding SIB's insurance coverage and regarding the safety and liquidity of SIB's investment portfolio.

29. In addition, Green made oral misrepresentations about the safety of the SIB CD, the diversity and liquidity of SIB's underlying investment portfolio, and insurance. For example, Green:

(a) told a Louisiana investor who was looking for a risk-free investment that the SIB CDs were "as safe as U.S. treasuries";

(b) told a Louisiana retiree that the SIB CDs were "insured by Lloyd's of London";

(c) told a Louisiana investor who was concerned solely with capital preservation that SIB was safer than U.S. banks and that the purported insurance program protecting the SIB CDs was stronger than FDIC coverage.

## Violations

30. As a result of the conduct described above, the Respondents willfully violated Section 17(a) of the Securities Act, which prohibits, directly or indirectly, employing any device, scheme, or artifice to defraud, obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made not misleading, in the offer or sale of securities, or engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser, in the offer or sale of any securities.

31. As a result of the conduct described above, the Respondents willfully violated and/or willfully aided and abetted and caused SIB's and SGC's violations of Section 10(b) of the Exchange Act and Rules 10b-5 thereunder, which prohibits, directly or indirectly, employing any device, scheme, or artifice to defraud, the making of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made not misleading, or engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of securities.

32. As a result of the conduct described above, the Respondents willfully aided and abetted and caused SGC's violations of Section 15(c)(1) of the Exchange Act, which prohibits a broker-dealer from using the mails or any means or instrumentality of interstate commerce to induce the purchase or sale of any security by means of any manipulative, deceptive, or other fraudulent device or contrivance.

33. As a result of the conduct described above, the Respondents willfully aided and abetted and caused SGC's violations of Sections 206(1) and (2) of the Advisers Act, which make it unlawful for an adviser to employ any device, scheme, or artifice to defraud any client or to engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client.

**III.**

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against the Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against the Respondents pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Sections 203(i) and 203(j) of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against the Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9(d) of the Investment Company Act; and

E. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, the Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act, Sections 10(b) and 15(c)(1) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act; whether the Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, Section 203 of the Advisers Act, and Section 9 of the Investment Company Act, and whether the Respondents should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act, and Section 21B(a) of the Exchange Act, and Section 203(i) of the Advisers Act.

## IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that the Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If the Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon the Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar.
not participating

**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**
**Release No. 67767 / August 31, 2012**

**ACCOUNTING AND AUDITING ENFORCEMENT**
**Release No. 3403 / August 31, 2012**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-15001**

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|---|---|
| **In the Matter of**<br><br>**FEDERICO QUINTO, JR., CPA,**<br><br>**Respondent.** | **ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS** |

## I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Federico Quinto, Jr., CPA ("Respondent" or "Quinto") pursuant to Section 4C[1] of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

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[1] Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

[2] Rule 102(e)(1)(ii) provides, in pertinent part, that:

> The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

## II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds[3] that:

### A. SUMMARY

1. These proceedings arise out of Respondent's improper professional conduct as the engagement partner on the 2007 audit (the "Audit") and first three quarterly reviews of 2008 (the "Quarterly Reviews") of Soyo Group, Inc.'s ("Soyo") financials. In this capacity, Quinto failed to ensure that Vasquez & Company, LLP's ("Vasquez") engagement team for Soyo adhered to the Standards of the Public Company Accounting Oversight Board ("PCAOB Standards") in performing audit and review procedures in key areas, such as debt and going concern. Quinto's improper professional conduct included: failure to obtain sufficient competent evidential matter; failure to properly consider Soyo's ability to continue as a going concern; failure to modify the auditor's report appropriately when Soyo did not make required disclosures; failure to act with due professional care; failure to prepare and maintain adequate work papers; and failure to adhere to standards of conducting reviews of interim financial information.

### B. RESPONDENT

2. **Federico "Jun" Quinto, Jr., CPA**, age 57, is a resident of Cerritos, California. Quinto is a principal at the Vasquez accounting firm and served as the engagement partner on the Soyo Audit and Quarterly Reviews. As the engagement partner, Quinto was ultimately responsible for the overall conduct of the Audit and Quarterly Reviews. Quinto is a certified public accountant licensed in the state of California.

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[3] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

## C. OTHER RELEVANT PARTIES

3. **Vasquez & Company, LLP**, a limited liability partnership headquartered in Los Angeles, California, is a public accounting firm registered with the Public Company Accounting Oversight Board ("Board") engaged in the business of providing auditing, tax, and consulting services. Vasquez issued an unqualified opinion in its auditor's report in connection with its audit of Soyo's 2007 financial statements and included, with Vasquez's consent, in Soyo's 2007 Form 10-K. Vasquez personnel also performed the Quarterly Reviews.

4. **Soyo Group, Inc.** was, at the time of the relevant conduct discussed herein, a Nevada corporation located in Ontario, California, primarily in the business of selling televisions, monitors, computer parts and peripherals through its wholly-owned subsidiary. Soyo voluntarily filed periodic reports with the Commission and Vasquez committed to perform its engagements associated with such filings in accordance with PCAOB Standards. Soyo's common stock had been quoted on OTC Link, but such quotations have now been discontinued. On May 5, 2009, Soyo filed for bankruptcy protection. Soyo has ceased all business operations and is liquidating under the supervision of a receiver.

## D. FACTS

### Background

5. During 2007 and the first three quarters of 2008, Soyo booked over $47 million in sales from at least 120 fictitious transactions with 21 customers, resulting in material overstatements in Soyo's reported net revenues in several periodic reports filed with the Commission. While this fraud was being committed, Soyo was financing its business operations through millions in borrowings from United Commercial Bank ("UCB"). Notwithstanding the phony profits, Soyo struggled to obtain enough cash to continue its operations and it regularly violated its debt covenants with UCB. Indeed, to obtain additional bank financing for Soyo and keep its existing line of credit with UCB from defaulting, Soyo falsely reported in the second and third quarter of 2008 that it completed a $6 million debt-for-equity transaction with one of its vendors.

### Failure to Obtain Sufficient Competent Evidential Matter

6. Under PCAOB Standards, the Vasquez audit team was required to obtain sufficient competent evidential matter by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit. See PCAOB Interim Standard – AU § 326, *Evidential Matter*.[4]

[4] "AU" refers to the specific sections of the codification of the American Institute of Certified Public Accountants ("AICPA") professional standards, known as the Statements on Auditing Standards, as issued by the Auditing Standards Board of the AICPA. Following passage of the Sarbanes-Oxley Act of 2002, these standards were adopted as the PCAOB Standards in 2003. References in this Order are to the standards in effect at the time of the relevant conduct.

7. Quinto failed to ensure that the audit team performed appropriate audit procedures in the area of Soyo's debt obligations. In planning the Audit, the Vasquez audit team identified Soyo's asset-based credit line ("ABL") with UCB as a contract that had audit significance given the magnitude of the UCB debt on Soyo's balance sheet.[5] The audit team performed an analysis of the ABL and noted that Soyo was not in compliance with three of its six debt covenants as of December 31, 2007. The debt covenant violations were important because they were events of default under Soyo's lending agreement with UCB, and could have triggered the termination of the credit line and acceleration of the UCB debt. Such actions by UCB could have forced Soyo into bankruptcy as the company was highly dependent on its credit line to fund its ongoing business operations and Soyo did not have sufficient cash (or assets readily convertible to cash) to repay the UCB debt. Accordingly, the debt covenant violations, if not waived, could have had catastrophic consequences for Soyo. Yet Quinto and the other members of the audit team did not make any inquiries of UCB about Soyo's ABL debt covenant violations or otherwise obtain evidence supporting a waiver.

8. In addition, the Vasquez audit team's work with respect to the multi-million dollar purchase order financing line with UCB was also deficient, as there was a complete absence of documentation or analysis of the terms and conditions of the purchase order financing line, rendering it impossible to determine if Soyo was in compliance with that debt obligation as of December 31, 2007.[6]

## Failure to Properly Consider Soyo's Ability to Continue as a Going Concern

9. Under PCAOB Standards, the Vasquez audit team had the responsibility to evaluate whether there was substantial doubt about Soyo's ability to continue as a going concern for a reasonable period of time. See PCAOB Interim Standard – AU § 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.*

10. There were numerous conditions and events Quinto knew or should have known during the Audit that, in the aggregate, indicated there could be substantial doubt about Soyo's ability to continue as a going concern for a reasonable period of time. Those conditions and events were that:

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[5] As of December 31, 2007, Soyo's total debt with UCB was approximately $27.8 million, or 63 percent of Soyo's total liabilities. Around $16.9 million of this debt was associated with the ABL with UCB while the remainder was a purchase order financing line with UCB.

[6] The audit team also failed to obtain sufficient competent evidential matter to support increases to the ABL during 2007 (from $12 million to $17 million) that were disclosed in Soyo's 2007 Form 10-K. For example, there is no support in Vasquez's audit work papers that the credit limits for the ABL were increased in April and December of 2007, or that all other terms of those agreements were unmodified. Moreover, Vasquez's audit work papers reflect no inquiry about why Soyo overdrew its ABL by approximately $1 million in the third quarter of 2007.

- Soyo was in violation of its debt covenants with UCB;[7]
- Soyo was heavily reliant on its borrowings with UCB;
- Soyo needed to extend the maturity date of the ABL due to its inability to pay;
- Soyo received credit limit increases to the ABL;
- Soyo had, during the year, exceeded its credit limit with UCB;
- Soyo was very near its credit limit on the ABL;
- UCB required Soyo's chief executive officer ("CEO") and chief financial officer ("CFO") to jointly sign a $6.5 million personal guaranty to obtain the ABL;
- UCB did not renew the purchase order financing line when it expired in February 2008; and
- Additional financing was expensive for Soyo.

11. Vasquez's audit work papers are devoid of any consideration of these events as they relate to going concern or any rationale for Vasquez's failure to evaluate going concern, even though during the pre-audit planning meeting the Vasquez audit team identified debt covenants as an area that needed testing because it could affect going concern.

**Failure to Modify the Auditor's Report Appropriately When Soyo Did Not Make Required Disclosures**

12. Under PCAOB Standards, if management omits from the financial statements, including the accompanying notes, information that is required by generally accepted accounting principles ("GAAP"), the auditor should express a qualified or an adverse opinion and should provide the information in the auditor's report, if practicable, unless its omission from the auditor's report is specifically recognized as appropriate. See PCAOB Interim Standard – AU § 431, *Adequacy of Disclosure in Financial Statements.*

13. Quinto failed to ensure adherence to this PCAOB Standard. Soyo was required to make specific disclosures in its financial statements with regard to its debt obligations, including the terms and conditions of the debt and whether Soyo had any events of non-compliance with its debt. See Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*, ¶¶ 18-19; SEC Regulation S-X, Rules 4-08(c) (requiring disclosures of covenant breaches and waivers) and 5-02-19(b) (requiring disclosure of the terms and conditions of significant short-term debt). Further, Vasquez's audit team advised Soyo that the company needed to make such disclosures. Soyo did not. Despite the known reporting deficiencies, Vasquez expressed an unqualified opinion and Quinto did not note the reporting deficiencies in Vasquez's auditor's report for 2007.[8] As discussed above, the debt covenant violations were likely material given that:

[7] AU § 341.06 states that conditions and events that could raise a going concern issue would include, for example, defaults on loan or similar agreements and the restructuring of debt.

[8] PCAOB Interim Standard – AU § 312.38, *Audit Risk and Materiality in Conducting an Audit*, states:

- Soyo was heavily dependent on the UCB debt to fund its business operations;
- Soyo had violated multiple debt covenants with UCB;
- Soyo's debt with UCB constituted a large percentage of Soyo's total liabilities; and
- Soyo did not have sufficient cash (or other liquid assets) or other available sources of financing to repay the UCB debt if called.

Vasquez only noted in its work papers that Soyo had debt covenants with respect to the ABL and was not in compliance with them, and that such would be disclosed in Soyo's next filing (which they were not).

**Failure to Act with Due Professional Care**

14. PCAOB Standards required Quinto to exercise due professional care throughout the audit. Due professional care means the auditor must act with professional skepticism – an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest. See PCAOB Interim Standard – AU § 230, *Due Professional Care in the Performance of Work.*

15. Quinto failed to maintain an attitude of professional skepticism in performing and reviewing the audit procedures with respect to Soyo's debt and with respect to evaluating Soyo as a going concern. As discussed above, Quinto did not probe whether Soyo's debt covenant violations, and other conditions and events related to its debt, presented any concerns, and ignored the impact of the debt covenant violations regarding the issue of going concern. In addition, although Quinto knew or should have known of the reporting deficiencies associated with Soyo's debt obligations, he did not appropriately modify Vasquez's opinion on the financial statements due to the omission of information required by GAAP.

**Failure to Prepare and Maintain Adequate Work Papers**

16. PCAOB Standards require that the auditor's work papers clearly demonstrate that the work was in fact performed. Audit documentation must also contain sufficient information to enable an experienced auditor, having no previous connection to the engagement, to: (1) understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached and (2) determine who performed the work, when the work was completed, and identify when the work was reviewed and by whom. See PCAOB Auditing Standard ("PCAOB AS") No. 3, *Audit Documentation.*

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If the auditor concludes, based on the accumulation of sufficient evidential matter, that the effects of likely misstatements, individually or in the aggregate, cause the financial statements to be materially misstated, the auditor should request management to eliminate the misstatement. If the material misstatement is not eliminated, the auditor should issue a qualified or an adverse opinion on the financial statements.

17. Quinto failed to ensure that the Vasquez audit team documented the work that they performed in a manner consistent with PCAOB Standards. Vasquez's audit work papers do not include any discussion of a waiver of Soyo's debt covenant violations, and there is no documentation of the rationale behind concluding that no substantial doubt exists about Soyo's ability to continue as a going concern for a reasonable period of time. Moreover, many of Vasquez's significant audit findings and issues are not included in Vasquez's engagement completion document.[9] These include, for instance, that:

- Soyo had violated its debt covenants with UCB;
- Soyo had overdrawn its credit limit on the ABL in the third quarter of 2007;
- UCB had increased the credit limit for the ABL in April and December of 2007;
- Soyo had almost fully utilized its available credit limit on the ABL with UCB;
- UCB had extended the maturity date for the ABL;
- Soyo's CEO and CFO provided a $6.5 million personal guaranty to UCB;
- UCB did not renew Soyo's purchase order financing line;
- Soyo had obtained an additional financing line at a high cost; and
- Soyo had the ability to continue as a going concern for a reasonable period of time.

**Failure to Adhere to Standards of Conducting Reviews of Interim Financial Information**

18. Quinto also failed to ensure that the Quarterly Reviews were performed in accordance with PCAOB Standards. A review of interim financial information consists primarily of analytical procedures and inquiries designed to address significant accounting and disclosure matters relating to the interim financial information to be reported. This would ordinarily include making inquiries regarding compliance with debt covenants and, if the auditor becomes aware of significant adverse conditions or events, going concern. Moreover, the auditor should prepare documentation of the interim review work performed that includes any significant findings or issues. See PCAOB Interim Standard – AU § 722, *Interim Financial Information.* As discussed below, each of the Quarterly Reviews of Soyo's financials was deficient.

***First Quarter of 2008***

19. As with the Audit, Vasquez's interim review work in the areas of debt, going concern, and documentation were inadequate. Vasquez's work papers for the first quarter of 2008 note that Soyo's ABL with UCB matured on May 5, 2008, yet no inquiry was made regarding Soyo's plans to repay or extend the debt prior to the filing of Soyo's first quarter 2008 Form 10-Q on May 15, 2008. Quinto was also informed that Soyo again overdrew the credit limit of its ABL by approximately $1 million (without UCB's consent) during the first quarter of 2008, but the

[9] PCAOB AS No. 3, ¶13 requires an auditor to identify all significant findings or issues in an engagement completion document.

work papers reflect no inquiry by Vasquez on this issue.[10] Further, the first quarter work papers show no inquiry regarding Soyo's compliance with its debt covenants related to the ABL, despite the fact that debt covenant violations were noted as of December 31, 2007. Quinto also did not require that Soyo correct the previously identified disclosure deficiencies in its financial statements regarding the failure to report its debt covenants and lack of compliance with them; which became even more significant as the debt covenant violations extended over multiple periods.

20. Although Vasquez's "Engagement Continuance Form" for the first quarter of 2008 states that Vasquez would assess going concern due to Soyo's liquidity issues, Vasquez failed to perform any such inquiries during its interim review. In addition to the adverse conditions and events regarding Soyo's debt that existed during the Audit, in the first quarter of 2008, Quinto knew or should have known that the following circumstances further indicated that there could be substantial doubt about Soyo's ability to continue as a going concern for a reasonable period of time:

- Soyo's ABL with UCB was due on May 5, 2009 (prior to filing the Form 10-Q for the period ended March 31, 2008), but was not paid off at maturity;
- Soyo had exceeded its credit limit on the ABL without UCB's consent in the first quarter of 2008;
- Vasquez's analytic review states that Soyo's accounts payable had increased in the first quarter of 2008 due to a liquidity problem; and
- Soyo's accounts receivables over 30 days due increased sharply from 11 percent to 27 percent in the first quarter of 2008, thus indicating possible collection issues.

Under these circumstances, Quinto should have ensured that the Soyo engagement team made inquiries regarding management's plan to address the adverse conditions and document their findings. He did not.

21. In addition, none of the issues discussed in this section were included in Vasquez's engagement completion document for the first quarter of 2008.

***Second Quarter of 2008***

22. Vasquez's deficient interim review work continued into the second quarter of 2008. Vasquez's interim review work papers for that quarter confirm that Soyo had, in fact, been in violation of its debt covenants with UCB in the first quarter of 2008.[11] Again, no inquiry was performed in the second quarter about any waiver of the historical debt covenant violations.

[10] Soyo's first quarter 2008 Form 10-Q states that the ABL credit limit was raised from $17 million to $18 million, which would negate a default, but the work papers do not reflect any inquiry by the Soyo engagement team regarding this purported credit limit increase.

[11] As mentioned previously, Soyo was in compliance with its debt covenants in the second quarter of 2008, but due only to its recording of the phony $6 million debt-for-equity swap.

Furthermore, Soyo ignored Vasquez's comments in the second quarter of 2008 to include additional disclosures regarding the terms of its debt obligations. Yet the work papers reflect no inquiry by Quinto (or anyone else) of Soyo's management as to why Vasquez's comments were not addressed. Moreover, in the second quarter of 2008, Quinto again failed to ensure that the Soyo engagement team consider the going concern issue, even though there were further indicators that Soyo's viability was uncertain. These included, in addition to the conditions previously mentioned, that:

- Vasquez stated, in its "Business Risk Identification and Planning Form," that it expected Soyo to have difficulty meeting its financing and working capital requirements;
- Soyo had utilized 99.6 percent of its consolidated credit line with UCB by June 30, 2008;
- Soyo had applied for, but did not obtain, new lines of credit in the second quarter of 2008;
- Quinto was aware that Soyo was struggling to maintain its profitability in order to obtain additional financing; and
- Only 44 percent of Soyo's accounts receivable were current (as opposed to 88 percent as of December 31, 2007) by the end of the second quarter of 2008.

23. As with the first quarter, none of the issues discussed in this section were mentioned in the engagement completion document for the second quarter of 2008.

***Third Quarter of 2008***

24. In the third quarter of 2008, Quinto again failed to ensure that the Soyo engagement team properly consider whether there was substantial doubt about Soyo's ability to continue as a going concern for a reasonable period of time. Adding to the already sizable amount of evidence indicating that Soyo faced significant financial difficulties, during the third quarter, Quinto knew or should have known of the following additional events and conditions:

- Quinto was informed that Soyo was struggling to find financing;
- Soyo's accounts receivables balance, aging (days sales outstanding), and bad debt write-offs all increased, indicating that Soyo was continuing to have difficulty collecting from its customers;
- Soyo obtained an additional loan from UCB that matured on November 5, 2008, without being paid off (prior to the filing of the Form 10-Q for the third quarter of 2008), and Soyo's CEO and CFO had to provide an additional $900,000 personal guaranty on this loan;
- Vasquez's "Business Risk Identification and Planning Form" stated that Soyo had used all available credit by the end of the third quarter; and
- Soyo had to obtain a $557,000 loan from a friend of its CFO, reflecting that the company was forced to resort to unconventional means of financing.

25. Nevertheless, neither the third quarter engagement completion document nor the work papers as a whole reflect any inquiry or consideration in the area of going concern.

## E. VIOLATIONS

26. Rule 102(e)(1)(ii) provides that the Commission may temporarily or permanently deny an accountant the privilege of appearing or practicing before it if it finds, after notice and opportunity for hearing, that the accountant engaged in "improper professional conduct." Such improper professional conduct includes, as applicable here, negligent conduct, defined as "[r]epeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." Rule 102(e)(1)(iv)(B)(2).

27. Quinto, as engagement partner, was responsible for ensuring that the Audit and Quarterly Reviews were conducted in accordance with PCAOB Standards. Instead, under Quinto's leadership, Vasquez's engagement team for Soyo: failed to obtain sufficient competent evidential matter, AU § 326; failed to properly consider Soyo's ability to continue as a going concern, AU § 341; failed to modify the auditor's report appropriately when Soyo did not make required disclosures, AU § 431; failed to act with due professional care, AU § 230; failed to prepare and maintain adequate work papers, PCAOB AS No. 3; and failed to adhere to standards of conducting reviews of interim financial information, AU § 722. These multiple audit and quarterly review failures demonstrate that Quinto's actions during the Soyo engagements were unreasonable, failed to conform to applicable professional standards, and indicate a lack of competence to practice before the Commission.

## F. FINDINGS

28. Based on the foregoing, the Commission finds that Quinto engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

## IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Quinto's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Quinto is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After one year from the date of this Order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Board in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary



Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

**[Release Nos. 33-9357; 34-67771 / August 31, 2012]**

## Order Making Fiscal Year 2013 Annual Adjustments to Registration Fee Rates

## I. Background

The Commission collects fees under various provisions of the securities laws. Section 6(b) of the Securities Act of 1933 ("Securities Act") requires the Commission to collect fees from issuers on the registration of securities.[1] Section 13(e) of the Securities Exchange Act of 1934 ("Exchange Act") requires the Commission to collect fees on specified repurchases of securities.[2] Section 14(g) of the Exchange Act requires the Commission to collect fees on proxy solicitations and statements in corporate control transactions.[3]

The Investor and Capital Markets Fee Relief Act of 2002 ("Fee Relief Act")[4] required the Commission to make annual adjustments to the fee rates applicable under these sections for each of the fiscal years 2003 through 2011 in an attempt to generate collections equal to yearly targets specified in the statute.[5] Under the Fee Relief Act, each year's fee rate was announced on the preceding April 30, and took effect five days after the date of enactment of the Commission's regular appropriation.

1 15 U.S.C. 77f(b).

2 15 U.S.C. 78m(e).

3 15 U.S.C. 78n(g).

4 Pub. L. No. 107-123, 115 Stat. 2390 (2002).

5 *See* 15 U.S.C. §§ 77f(b)(5), 77f(b)(6), 78m(e)(5), 78m(e)(6), 78n(g)(5) and 78n(g)(6).

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[6] changed many of the provisions related to these fees. The Dodd-Frank Act created new annual collection targets for FY 2012 and thereafter. It also changed the date by which the Commission must announce a new fiscal year's fee rate (August 31) and the date on which the new rate takes effect (October 1).

## II. Fiscal Year 2013 Annual Adjustment to the Fee Rate

Section 6(b)(2) of the Securities Act, as amended by the Dodd-Frank Act, requires the Commission to make an annual adjustment to the fee rate applicable under Section 6(b).[7] The annual adjustment to the fee rate under Section 6(b) of the Securities Act also sets the annual adjustment to the fee rates under Sections 13(e) and 14(g) of the Exchange Act.[8]

Section 6(b)(2) sets forth the method for determining the annual adjustment to the fee rate under Section 6(b) for fiscal year 2013. Specifically, the Commission must adjust the fee rate under Section 6(b) to a "rate that, when applied to the baseline estimate of the aggregate maximum offering prices for [fiscal year 2013], is reasonably likely to produce aggregate fee collections under [Section 6(b)] that are equal to the target fee collection amount for [fiscal year 2013]." That is, the adjusted rate is determined by dividing the "target fee collection amount" for fiscal year 2013 by the "baseline estimate of the aggregate maximum offering prices" for fiscal year 2013.

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6 Pub. L. No. 111-203, 124 Stat.1376 (2010).

7 15 U.S.C. § 77f(b)(2). The annual adjustments are designed to adjust the fee rate in a given fiscal year so that, when applied to the aggregate maximum offering price at which securities are proposed to be offered for the fiscal year, it is reasonably likely to produce total fee collections under Section 6(b) equal to the "target fee collection amount" specified in Section 6(b)(6)(A) for that fiscal year.

8 15 U.S.C. § 78m(e)(4) and 15 U.S.C. § 78n(g)(4).

Section 6(b)(6)(A) specifies that the "target fee collection amount" for fiscal year 2013 is $455,000,000. Section 6(b)(6)(B) defines the "baseline estimate of the aggregate maximum offering price" for fiscal year 2013 as "the baseline estimate of the aggregate maximum offering price at which securities are proposed to be offered pursuant to registration statements filed with the Commission during [fiscal year 2013] as determined by the Commission, after consultation with the Congressional Budget Office and the Office of Management and Budget . . . ."

To make the baseline estimate of the aggregate maximum offering price for fiscal year 2013, the Commission used a methodology similar to that developed in consultation with the Congressional Budget Office ("CBO") and Office of Management and Budget ("OMB") to project the aggregate offering price for purposes of the fiscal year 2012 annual adjustment.[9] Using this methodology, the Commission determines the "baseline estimate of the aggregate maximum offering price" for fiscal year 2013 to be $3,336,846,226,098.[10] Based on this estimate, the Commission calculates the fee rate for fiscal 2013 to be $136.40 per million. This adjusted fee rate applies to Section 6(b) of the Securities Act, as well as to Sections 13(e) and 14(g) of the Exchange Act.

9 For the fiscal year 2011 estimate, the Commission used a ten-year series of monthly observations ending in March 2011. For fiscal year 2012, the Commission used a ten-year series ending in July 2011. For fiscal year 2013, the Commission used a ten-year series ending in July 2012.

10 Appendix A explains how we determined the "baseline estimate of the aggregate maximum offering price" for fiscal year 2013 using our methodology, and then shows the purely arithmetical process of calculating the fiscal year 2013 annual adjustment based on that estimate. The appendix includes the data used by the Commission in making its "baseline estimate of the aggregate maximum offering price" for fiscal year 2013.

## III. Effective Dates of the Annual Adjustments

The fiscal year 2013 annual adjustments to the fee rates applicable under Section 6(b) of the Securities Act and Sections 13(e) and 14(g) of the Exchange Act will be effective on October 1, 2012.[11]

## IV. Conclusion

Accordingly, pursuant to Section 6(b) of the Securities Act and Sections 13(e) and 14(g) of the Exchange Act,[12]

IT IS HEREBY ORDERED that the fee rates applicable under Section 6(b) of the Securities Act and Sections 13(e) and 14(g) of the Exchange Act shall be $136.40 per million effective on October 1, 2012.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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11 15 U.S.C. § 77f(b)(4), 15 U.S.C. § 78m(e)(6) and 15 U.S.C. § 78n(g)(6).

12 15 U.S.C. 77f(b), 78m(e) and 78n(g).

## APPENDIX A

With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress has, among other things, established a target amount of monies to be collected from fees charged to issuers based on the value of their registrations. This appendix provides the formula for determining such fees, which the Commission adjusts annually. Congress has mandated that the Commission determine these fees based on the "aggregate maximum offering prices," which measures the aggregate dollar amount of securities registered with the Commission over the course of the year. In order to maximize the likelihood that the amount of monies targeted by Congress will be collected, the fee rate must be set to reflect projected aggregate maximum offering prices. As a percentage, the fee rate equals the ratio of the target amounts of monies to the projected aggregate maximum offering prices.

For 2013, the Commission has estimated the aggregate maximum offering prices by projecting forward the trend established in the previous decade. More specifically, an ARIMA model was used to forecast the value of the aggregate maximum offering prices for months subsequent to July 2012, the last month for which the Commission has data on the aggregate maximum offering prices.

The following sections describe this process in detail.

**A. Baseline estimate of the aggregate maximum offering prices for fiscal year 2013.**

First, calculate the aggregate maximum offering prices (AMOP) for each month in the sample (July 2002 - July 2012). Next, calculate the percentage change in the AMOP from month to month.

Model the monthly percentage change in AMOP as a first order moving average process. The moving average approach allows one to model the effect that an exceptionally high (or low) observation of AMOP tends to be followed by a more "typical" value of AMOP.

Use the estimated moving average model to forecast the monthly percent change in AMOP. These percent changes can then be applied to obtain forecasts of the total dollar value of registrations. The following is a more formal (mathematical) description of the procedure:

1. Begin with the monthly data for AMOP. The sample spans ten years, from July 2002 to July 2012.

2. Divide each month's AMOP (column C) by the number of trading days in that month (column B) to obtain the average daily AMOP (AAMOP, column D).

3. For each month t, the natural logarithm of AAMOP is reported in column E.

4. Calculate the change in log(AAMOP) from the previous month as $\Delta_t = \log(AAMOP_t) - \log(AAMOP_{t-1})$. This approximates the percentage change.

5. Estimate the first order moving average model $\Delta_t = \alpha + \beta e_{t-1} + e_t$, where $e_t$ denotes the forecast error for month t. The forecast error is simply the difference between the one-month ahead forecast and the actual realization of $\Delta_t$. The forecast error is expressed as $e_t = \Delta_t - \alpha - \beta e_{t-1}$. The model can be estimated using standard commercially available software. Using least squares, the estimated parameter values are $\alpha$=0.0016886 and $\beta$=−0.85600.

6. For the month of August 2012 forecast $\Delta_{t=8/12} = \alpha + \beta e_{t=7/12}$. For all subsequent months, forecast $\Delta_t = \alpha$.

7. Calculate forecasts of log(AAMOP). For example, the forecast of log(AAMOP) for October 2012 is given by $FLAAMOP_{t=10/12} = \log(AAMOP_{t=7/12}) + \Delta_{t=8/12} + \Delta_{t=9/12} + \Delta_{t=10/12}$.

8. Under the assumption that $e_t$ is normally distributed, the n-step ahead forecast of AAMOP is given by $\exp(FLAAMOP_t + \sigma_n^2/2)$, where $\sigma_n$ denotes the standard error of the n-step ahead forecast.

9. For October 2012, this gives a forecast AAMOP of $13.0 billion (Column I), and a forecast AMOP of $299.4 billion (Column J).

10. Iterate this process through September 2013 to obtain a baseline estimate of the aggregate maximum offering prices for fiscal year 2013 of $3,336,846,226,098.

**B. Using the forecasts from A to calculate the new fee rate.**

1. Using the data from Table A, estimate the aggregate maximum offering prices between 10/1/12 and 9/30/13 to be $3,336,846,226,098.

2. The rate necessary to collect the target $455,000,000 in fee revenues set by Congress is then calculated as: $455,000,000 ÷ $3,336,846,226,098= 0.000136356.

3. Round the result to the seventh decimal point, yielding a rate of 0.0001364 (or $136.40 per million).

**Table A. Estimation of baseline of aggregate maximum offering prices .**

**Fee rate calculation.**

| | |
|---|---|
| a. Baseline estimate of the aggregate maximum offering prices, 10/1/12 to 9/30/13 ($Millions) | 3,336,846 |
| b. Implied fee rate ($455 Million / a) | $136.40 |

**Data**

| (A) Month | (B) # of Trading Days in Month | (C) Aggregate Maximum Offering Prices, in $Millions | (D) Average Daily Aggregate Max. Offering Prices (AAMOP) in $Millions | (E) log(AAMOP) | (F) Change in AAMOP | (G) Forecast log(AAMOP) | (H) Standard Error | (I) Forecast AAMOP, in $Millions | (J) Forecast Aggregate Maximum Offering Prices, in $Millions |
|---|---|---|---|---|---|---|---|---|---|
| Jul-02 | 22 | 208,638 | 9,484 | 22.973 | | | | | |
| Aug-02 | 22 | 265,750 | 12,080 | 23.215 | 0.242 | | | | |
| Sep-02 | 20 | 109,565 | 5,478 | 22.424 | -0.791 | | | | |
| Oct-02 | 23 | 179,374 | 7,799 | 22.777 | 0.353 | | | | |
| Nov-02 | 20 | 243,590 | 12,179 | 23.223 | 0.446 | | | | |
| Dec-02 | 21 | 212,838 | 10,135 | 23.039 | -0.184 | | | | |
| Jan-03 | 21 | 201,839 | 9,611 | 22.986 | -0.053 | | | | |
| Feb-03 | 19 | 144,642 | 7,613 | 22.753 | -0.233 | | | | |
| Mar-03 | 21 | 444,331 | 21,159 | 23.775 | 1.022 | | | | |
| Apr-03 | 21 | 142,373 | 6,780 | 22.637 | -1.138 | | | | |
| May-03 | 21 | 328,792 | 15,657 | 23.474 | 0.837 | | | | |
| Jun-03 | 21 | 281,580 | 13,409 | 23.319 | -0.155 | | | | |
| Jul-03 | 22 | 304,383 | 13,836 | 23.351 | 0.031 | | | | |
| Aug-03 | 21 | 328,351 | 15,636 | 23.473 | 0.122 | | | | |
| Sep-03 | 21 | 459,563 | 21,884 | 23.809 | 0.336 | | | | |
| Oct-03 | 23 | 285,039 | 12,393 | 23.240 | -0.569 | | | | |
| Nov-03 | 19 | 257,779 | 13,567 | 23.331 | 0.091 | | | | |
| Dec-03 | 22 | 244,998 | 11,136 | 23.133 | -0.197 | | | | |
| Jan-04 | 20 | 369,784 | 18,489 | 23.640 | 0.507 | | | | |
| Feb-04 | 19 | 221,517 | 11,659 | 23.179 | -0.461 | | | | |
| Mar-04 | 23 | 448,543 | 19,502 | 23.694 | 0.514 | | | | |
| Apr-04 | 21 | 260,029 | 12,382 | 23.240 | -0.454 | | | | |
| May-04 | 20 | 227,239 | 11,362 | 23.154 | -0.086 | | | | |
| Jun-04 | 21 | 370,668 | 17,651 | 23.594 | 0.441 | | | | |
| Jul-04 | 21 | 305,519 | 14,549 | 23.401 | -0.193 | | | | |
| Aug-04 | 22 | 179,688 | 8,168 | 22.823 | -0.577 | | | | |
| Sep-04 | 21 | 357,007 | 17,000 | 23.556 | 0.733 | | | | |

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|---|---|---|---|---|---|---|---|---|---|
| Oct-04 | 21 | 254,489 | 12,119 | 23.218 | -0.338 | | | | |
| Nov-04 | 21 | 363,406 | 17,305 | 23.574 | 0.356 | | | | |
| Dec-04 | 22 | 570,918 | 25,951 | 23.979 | 0.405 | | | | |
| Jan-05 | 20 | 375,484 | 18,774 | 23.656 | -0.324 | | | | |
| Feb-05 | 19 | 338,922 | 17,838 | 23.605 | -0.051 | | | | |
| Mar-05 | 22 | 590,862 | 26,857 | 24.014 | 0.409 | | | | |
| Apr-05 | 21 | 282,018 | 13,429 | 23.321 | -0.693 | | | | |
| May-05 | 21 | 323,652 | 15,412 | 23.458 | 0.138 | | | | |
| Jun-05 | 22 | 517,022 | 23,501 | 23.880 | 0.422 | | | | |
| Jul-05 | 20 | 457,487 | 22,874 | 23.853 | -0.027 | | | | |
| Aug-05 | 23 | 605,534 | 26,328 | 23.994 | 0.141 | | | | |
| Sep-05 | 21 | 312,281 | 14,871 | 23.423 | -0.571 | | | | |
| Oct-05 | 21 | 258,956 | 12,331 | 23.235 | -0.187 | | | | |
| Nov-05 | 21 | 192,736 | 9,178 | 22.940 | -0.295 | | | | |
| Dec-05 | 21 | 308,134 | 14,673 | 23.409 | 0.469 | | | | |
| Jan-06 | 20 | 526,550 | 26,328 | 23.994 | 0.585 | | | | |
| Feb-06 | 19 | 301,446 | 15,866 | 23.487 | -0.506 | | | | |
| Mar-06 | 23 | 1,211,344 | 52,667 | 24.687 | 1.200 | | | | |
| Apr-06 | 19 | 407,345 | 21,439 | 23.788 | -0.899 | | | | |
| May-06 | 22 | 260,121 | 11,824 | 23.193 | -0.595 | | | | |
| Jun-06 | 22 | 375,296 | 17,059 | 23.560 | 0.367 | | | | |
| Jul-06 | 20 | 232,654 | 11,633 | 23.177 | -0.383 | | | | |
| Aug-06 | 23 | 310,050 | 13,480 | 23.325 | 0.147 | | | | |
| Sep-06 | 20 | 236,782 | 11,839 | 23.195 | -0.130 | | | | |
| Oct-06 | 22 | 213,342 | 9,697 | 22.995 | -0.200 | | | | |
| Nov-06 | 21 | 292,456 | 13,926 | 23.357 | 0.362 | | | | |
| Dec-06 | 20 | 349,512 | 17,476 | 23.584 | 0.227 | | | | |
| Jan-07 | 20 | 372,740 | 18,637 | 23.648 | 0.064 | | | | |
| Feb-07 | 19 | 278,753 | 14,671 | 23.409 | -0.239 | | | | |
| Mar-07 | 22 | 862,786 | 39,218 | 24.392 | 0.983 | | | | |
| Apr-07 | 20 | 562,103 | 28,105 | 24.059 | -0.333 | | | | |
| May-07 | 22 | 470,843 | 21,402 | 23.787 | -0.272 | | | | |
| Jun-07 | 21 | 586,822 | 27,944 | 24.053 | 0.267 | | | | |
| Jul-07 | 21 | 326,612 | 15,553 | 23.468 | -0.586 | | | | |

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|---|---|---|---|---|---|---|---|---|---|
| Aug-07 | 23 | 369,172 | 16,051 | 23.499 | 0.032 | | | | |
| Sep-07 | 19 | 241,059 | 12,687 | 23.264 | -0.235 | | | | |
| Oct-07 | 23 | 239,652 | 10,420 | 23.067 | -0.197 | | | | |
| Nov-07 | 21 | 458,654 | 21,841 | 23.807 | 0.740 | | | | |
| Dec-07 | 20 | 410,200 | 20,510 | 23.744 | -0.063 | | | | |
| Jan-08 | 21 | 354,433 | 16,878 | 23.549 | -0.195 | | | | |
| Feb-08 | 20 | 263,410 | 13,171 | 23.301 | -0.248 | | | | |
| Mar-08 | 20 | 596,923 | 29,846 | 24.119 | 0.818 | | | | |
| Apr-08 | 22 | 292,534 | 13,297 | 23.311 | -0.809 | | | | |
| May-08 | 21 | 456,077 | 21,718 | 23.801 | 0.491 | | | | |
| Jun-08 | 21 | 461,087 | 21,957 | 23.812 | 0.011 | | | | |
| Jul-08 | 22 | 232,896 | 10,586 | 23.083 | -0.730 | | | | |
| Aug-08 | 21 | 395,440 | 18,830 | 23.659 | 0.576 | | | | |
| Sep-08 | 21 | 177,636 | 8,459 | 22.858 | -0.800 | | | | |
| Oct-08 | 23 | 360,494 | 15,674 | 23.475 | 0.617 | | | | |
| Nov-08 | 19 | 288,911 | 15,206 | 23.445 | -0.030 | | | | |
| Dec-08 | 22 | 319,584 | 14,527 | 23.399 | -0.046 | | | | |
| Jan-09 | 20 | 375,065 | 18,753 | 23.655 | 0.255 | | | | |
| Feb-09 | 19 | 249,666 | 13,140 | 23.299 | -0.356 | | | | |
| Mar-09 | 22 | 739,931 | 33,633 | 24.239 | 0.940 | | | | |
| Apr-09 | 21 | 235,914 | 11,234 | 23.142 | -1.097 | | | | |
| May-09 | 20 | 329,522 | 16,476 | 23.525 | 0.383 | | | | |
| Jun-09 | 22 | 357,524 | 16,251 | 23.511 | -0.014 | | | | |
| Jul-09 | 22 | 185,187 | 8,418 | 22.854 | -0.658 | | | | |
| Aug-09 | 21 | 192,726 | 9,177 | 22.940 | 0.086 | | | | |
| Sep-09 | 21 | 189,224 | 9,011 | 22.922 | -0.018 | | | | |
| Oct-09 | 22 | 215,720 | 9,805 | 23.006 | 0.085 | | | | |
| Nov-09 | 20 | 248,353 | 12,418 | 23.242 | 0.236 | | | | |
| Dec-09 | 22 | 340,464 | 15,476 | 23.463 | 0.220 | | | | |
| Jan-10 | 19 | 173,235 | 9,118 | 22.933 | -0.529 | | | | |
| Feb-10 | 19 | 209,963 | 11,051 | 23.126 | 0.192 | | | | |
| Mar-10 | 23 | 432,934 | 18,823 | 23.658 | 0.533 | | | | |
| Apr-10 | 21 | 280,188 | 13,342 | 23.314 | -0.344 | | | | |
| May-10 | 20 | 278,611 | 13,931 | 23.357 | 0.043 | | | | |

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|---|---|---|---|---|---|---|---|---|---|
| Jun-10 | 22 | 364,251 | 16,557 | 23.530 | 0.173 | | | | |
| Jul-10 | 21 | 171,191 | 8,152 | 22.822 | -0.709 | | | | |
| Aug-10 | 22 | 240,793 | 10,945 | 23.116 | 0.295 | | | | |
| Sep-10 | 21 | 260,783 | 12,418 | 23.242 | 0.126 | | | | |
| Oct-10 | 21 | 214,988 | 10,238 | 23.049 | -0.193 | | | | |
| Nov-10 | 21 | 340,112 | 16,196 | 23.508 | 0.459 | | | | |
| Dec-10 | 22 | 297,992 | 13,545 | 23.329 | -0.179 | | | | |
| Jan-11 | 20 | 233,668 | 11,683 | 23.181 | -0.148 | | | | |
| Feb-11 | 19 | 252,785 | 13,304 | 23.311 | 0.130 | | | | |
| Mar-11 | 23 | 595,198 | 25,878 | 23.977 | 0.665 | | | | |
| Apr-11 | 20 | 236,355 | 11,818 | 23.193 | -0.784 | | | | |
| May-11 | 21 | 319,053 | 15,193 | 23.444 | 0.251 | | | | |
| Jun-11 | 22 | 359,727 | 16,351 | 23.518 | 0.073 | | | | |
| Jul-11 | 20 | 215,391 | 10,770 | 23.100 | -0.418 | | | | |
| Aug-11 | 23 | 179,870 | 7,820 | 22.780 | -0.320 | | | | |
| Sep-11 | 21 | 168,005 | 8,000 | 22.803 | 0.023 | | | | |
| Oct-11 | 21 | 181,452 | 8,641 | 22.880 | 0.077 | | | | |
| Nov-11 | 21 | 256,418 | 12,210 | 23.226 | 0.346 | | | | |
| Dec-11 | 21 | 237,652 | 11,317 | 23.150 | -0.076 | | | | |
| Jan-12 | 20 | 276,965 | 13,848 | 23.351 | 0.202 | | | | |
| Feb-12 | 20 | 228,419 | 11,421 | 23.159 | -0.193 | | | | |
| Mar-12 | 22 | 430,806 | 19,582 | 23.698 | 0.539 | | | | |
| Apr-12 | 20 | 173,626 | 8,681 | 22.884 | -0.813 | | | | |
| May-12 | 22 | 414,122 | 18,824 | 23.658 | 0.774 | | | | |
| Jun-12 | 21 | 272,218 | 12,963 | 23.285 | -0.373 | | | | |
| Jul-12 | 21 | 170,462 | 8,117 | 22.817 | -0.468 | | | | |
| Aug-12 | 23 | | | | | 23.217 | 0.365 | 12,939 | 297,607 |
| Sep-12 | 19 | | | | | 23.219 | 0.369 | 12,979 | 246,606 |
| Oct-12 | 23 | | | | | 23.220 | 0.373 | 13,019 | 299,441 |
| Nov-12 | 21 | | | | | 23.222 | 0.376 | 13,059 | 274,244 |
| Dec-12 | 20 | | | | | 23.224 | 0.380 | 13,099 | 261,988 |
| Jan-13 | 21 | | | | | 23.225 | 0.384 | 13,140 | 275,934 |
| Feb-13 | 19 | | | | | 23.227 | 0.387 | 13,180 | 250,423 |
| Mar-13 | 20 | | | | | 23.229 | 0.391 | 13,221 | 264,414 |

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|---|---|---|---|---|---|---|---|---|---|
| Apr-13 | 22 | | | | | 23.230 | 0.394 | 13,261 | 291,750 |
| May-13 | 22 | | | | | 23.232 | 0.398 | 13,302 | 292,648 |
| Jun-13 | 20 | | | | | 23.234 | 0.401 | 13,343 | 266,862 |
| Jul-13 | 22 | | | | | 23.235 | 0.405 | 13,384 | 294,451 |
| Aug-13 | 22 | | | | | 23.237 | 0.408 | 13,425 | 295,357 |
| Sep-13 | 20 | | | | | 23.239 | 0.412 | 13,467 | 269,333 |

**Figure A**

Aggregate Maximum Offering Prices Subject to Securities Act Section 6(b)

(Dashed Line Indicates Forecast Values)