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E-ALERT | Conflict Minerals

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ADOPTION BY THE COMMISSION OF THE PROPOSAL ON CONFLICT MINERALS

On March 5, following a lengthy period of planning and consultation (that began in October 2012), the European Commission formally published its initiative on responsible sourcing of minerals originating in "conflict affected and high-risk areas." As discussed below, the initiative addresses the same policy goals as the Dodd-Frank legislation enacted in 2010 – i.e., curbing the violence and human rights abuses fuelled by trade in so-called "conflict minerals" – but differs significantly in its methods and implementation.

The proposals are contained in two documents, being:

1. A Communication to the European Parliament and the Council that first describes the existing policy landscape, and then proposes an "integrated approach" that aims to (i) reduce opportunities for armed groups to trade in tin, tantalum, tungsten and gold in conflict afflicted areas, (ii) improve the ability of EU operators to comply with existing due diligence frameworks – with the help of various "incentives" - and also (iii) reduce "distortions in global markets for the four minerals" (distortions which have been created by the implementation of section 1502 of Dodd Frank). The Communication is available here.
2. A draft Regulation that establishes "a [European] Union system for supply chain due diligence self-certification of responsible importers of tin, tantalum, tungsten, their ores and gold originating from conflict affected and high risks areas." The draft Regulation is available here.

A key – and controversial – feature of the proposal is that the new requirements imposed on the mining industry and intermediaries are not mandatory, in contrast to the reporting regime under Dodd Frank. The European Commissioner for Trade, Karel De Gucht, who led the initiative, justified his decision to avoid mandatory rules and to use "carrots" instead of "sticks" by explaining that an unintended side-effect of Dodd Frank's mandatory requirements was damage to the economy of the Great Lakes region (which is reliant on mineral extraction), because many industry players had reacted to Dodd Frank by renouncing use of any minerals from that region altogether.

Instead of mandatory requirements, therefore, the draft Regulation creates a voluntary "self-certification" system for importers of tin, tantalum, tungsten and gold who choose to import "responsibly" into the European Union. In order to self-certify, importers must implement the OECD due diligence guidance; they must also provide audit assurances and disclose relevant information to the European Union Member States' competent authorities. The overall goal of the system is to facilitate the flow of information to end users.

Since the scheme is voluntary, the Communication also sets out some of the "carrots" designed to entice importers to join the self-certification system. In particular, the Communication enumerates a certain number of "accompanying measures", including public procurement incentives for certified companies that are intended to be used in the performance clauses of European Commission and Member State public procurement contracts. Together with the OECD, the Commission will also annually publish a list of smelters and refiners that are considered "responsible suppliers". The list

will specifically identify parties who source responsibly from conflict zones, to incentivize legitimate trade with these zones.

Notably, the EU self-certification scheme targets due diligence on upstream supply chain operators, rather than other actors in the ecosystem. De Gucht explains that "by targeting the importers i.e. before the minerals get spread across Europe to hundreds and thousands of factories to be used in millions of products, we focus on a critical point of the supply chain: the approximately 400 importers of these minerals; This is realistic to control."

The European Commission initiative targets the same minerals as does Section 1502 of Dodd Frank, but the geographical scope of the European initiative is different: it is not limited to the Great Lakes Region in Africa, but covers all "conflict affected and high risk areas," which the Regulation defines rather broadly as "areas in a state of armed conflict, fragile post-conflict as well as areas witnessing weak or non-existent governance and security, such as failed states, and widespread and systematic violations of international law, including human rights abuses." It remains to be seen whether this broad standard, which is consistent with that used in OECD due diligence guidance, will be workable for importers in practice as they work to comply with the initiative.

Despite these differences from Dodd Frank, the European Commission presents the initiative as "complementary" to Dodd Frank, and notes that even if the scope of Dodd Frank is formally restricted to US-listed companies, Dodd Frank nevertheless has considerable effects abroad, including in the EU, because suppliers to US-listed companies are being asked to contribute due diligence information in order to satisfy Dodd Frank's requirements. The new Commission initiative is, at least in part, intended to "help" compliance with Dodd Frank by ensuring that information on "upstream" providers who are certified is available for scrutiny by end-users downstream. The initiative is also intended to help correct the adverse side-effects of the US legislation by identifying certified and responsible upstream suppliers from conflict regions, enabling mining and economic activity to continue in these regions.

The draft Regulation has now been sent to the European Council and to the European Parliament for legislative scrutiny and approval. Given the timing of the upcoming European Parliament elections on 25 May, it will not be examined by the existing Parliament, which will go in recess at the beginning of April, and instead will only be scrutinized by the next. However, given the elections, the new Parliament is not likely to start working on the proposal before the fall of this year; this, in turn, means that the draft Regulation is unlikely to become law until mid-2015 at the earliest.

It is difficult to predict how the next Parliament will view the Commission's proposal, but at this stage it seems reasonably likely that the Parliament will criticize the Commission's choice to adopt a voluntary approach instead of introducing mandatory rules. This reaction would be consistent with the current Parliament, which, in a (non-binding) resolution, voted last week for a mandatory legal framework, that includes sanctions where parties seek to avoid compliance. NGOs have also criticized the Commission proposal on the basis that it is not binding.

From the proposal's inception in October 2012, Covington & Burling has continuously monitored the progress of the Commission initiative. We will continue to closely follow the upcoming legislative discussion in the Parliament and in the Council as well as the implementation by the Commission of the proposal. At the same time, we also work with companies to enable compliance with Dodd Frank on a regular basis, and are preparing to help those companies use the tools provided by the Commission initiative, should it be enacted, to facilitate Dodd Frank reporting.

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