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Revisiting the Conflict Minerals Rule

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Companies listed in the U.S. are required by Section 1502 of the Dodd-Frank Act to report whether they manufacture products that incorporate so-called conflict minerals (defined as gold, tin, tungsten and tantalum coming from the Democratic Republic of Congo and its neighboring countries). The first part of this article reviews the conflict minerals rules of Dodd-Frank, and assesses their impact. In the authors' view, Dodd-Frank has failed to achieve its objective to reduce the financing of armed conflicts in Eastern Congo through the illegal trade in minerals, and has created a de facto embargo against minerals mined responsibly in the region.

The European Commission proposed in March 2014 conflict minerals rules for the EU. The second part of this article summarizes the proposed Regulation (and the impact assessment report and studies underpinning it), compares the EU proposal with the U.S.'s Dodd-Frank, and critically reviews it in view of its stated objective. In the authors' opinion, the EU proposal helps improve the ability of operators to perform due diligence of their supply chain. But it does not contain any meaningful incentive meant to foster the responsible sourcing of minerals from conflict areas. If adopted as such, the proposed EU rules are likely to result in the same embargo as the one Dodd-Frank created, but for the EU this time, and for potentially a lot more countries than the African countries targeted by Dodd-Frank.

1 Introduction

When the United States Congress included a much-criticized conflict minerals disclosure rule in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") in 2010, it did so with the best of intentions. The so-called "Conflict Minerals Rule" (section 1502 of the Act) was meant to help address an ongoing humanitarian crisis in the Democratic Republic of Congo (the "DRC") and adjoining countries by requiring companies that report to the Securities and Exchange Commission ("SEC") to disclose the use of certain conflict minerals in the products they manufacture or contract to manufacture. Whether the Conflict Minerals Rule will prove to be effective in accomplishing its goals of limiting the funding of armed groups through the exploitation of mineral resources very much remains to be seen. As commentators and industry closely analyze the first round of required disclosures, which were submitted in early June 2014, the initial returns appear to be that the cost to industry to comply with the rule were higher than expected, participation was far lower than expected, and the net result of the rule may be initiation of a highly-counterproductive de facto embargo of conflict minerals originating in the DRC and adjoining countries.

As the European Union ("EU") is working to design and implement its own conflict minerals disclosure mechanisms, it is worth revisiting the grand experiment of the Conflict Minerals Rule and whether it is workable to forcibly leverage private industry to accomplish social changes that are typically reserved for action at a national government level, and via inter-governmental and non-governmental organizations.

The critical challenge of the Conflict Minerals Rules is the inherent tension between forcing risk-averse companies to make disclosures that could invite public scrutiny and loss of shareholder value without having those companies eliminate the DRC and adjoining countries from their conflict mineral supply chains. In fact, the humanitarian goals of the Conflict Minerals Rule can only be accomplished if legitimate buyers remain engaged in the region. This means that the artisanal and

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small-scale mining and trading industries[1]—which are economically critical to the region—must in particular be supported to improve their commercial viability, legitimacy and professionalism, and to ensure they have the capacity to identify and manage the risks that determine their ability to deliver "conflict-free" minerals to the market. If the adoption of these rules produces the opposite outcome—further marginalization and criminalization of these miners—then it is failing to meet its humanitarian goal.

Because current conflict minerals disclosure rules and proposals lack proper incentives to source minerals responsibly from the conflict and neighboring regions, a large proportion of the companies subject to such rules appear to have chosen the simpler due diligence route of avoiding potentially-problematic sourcing of conflict minerals from the DRC, adjoining countries and in some cases even Africa at-large. Changing this response to disclosure rules will likely require the United States and other stakeholders to provide incentives to companies to source in-region. Only through commercial reinvestment in the legitimate mining industries of the African Great Lakes region can the ultimate goals of conflict minerals disclosure rules be achieved.

However, such reinvestment is unlikely to occur without critical improvements to industry infrastructure, such as: improving the general business climate in affected African Great Lakes nations by working with governments to attend to existing commercial barriers and risks (e.g., fiscal, infrastructure, corruption, bribery, import/export, banking, etc.); nurturing the capacity of business operators to conduct due diligence; helping civil society act as an effective monitor and whistleblower for flagging risks; and supporting the range of still-nascent mineral supply chain certification programs working upstream and downstream to improve supply chain transparency and risk management as the basis for generating market confidence. None of this will happen if private stakeholders chose to avoid conflict areas to comply with disclosure requirements imposed by the U.S., and possibly soon by the EU as well.

Ultimately, the Conflict Minerals Rule and its coming EU counterpart are forced to operate in a politically fraught environment that is preventing existing due diligence systems from coming to scale for the covered minerals, and an equally challenging commercial environment that is resistant to adopting new due diligence systems. The United States government and the governments of the EU's Member States can impact, through development aid and political pressure, the attitude, policies and actions of authorities in conflict areas. They can also have an impact on the behavior of private stakeholders, by setting up the right incentives to avoid de facto embargoes and instead drive responsible investment, including creating a market for responsible minerals sourced from conflict-affected and high-risk areas. This will bring local businesses the stability and capital they need to invest in due diligence and improve the situation on the ground.

2 Dodd-frank

2.1 *The Early Days of the Conflict Minerals Rule of Dodd-Frank*

2.1.1 *Goals and Purposes of the Rule*

The Conflict Minerals Rule was enacted pursuant to section 1502 of the Dodd-Frank Act.[2] The Rule requires that all companies required to file periodic reports with the SEC (i.e., publicly traded companies, including foreign issuers with securities registered in the United States) make annual disclosures regarding their trade in a limited number of specifically enumerated minerals designated as "conflict minerals." The conflict minerals are:

– *Cassiterite* (the metal ore most commonly used to produce *tin*).
– *Columbite-tantalite* (*coltan*) (the metal ore from which *tantalum* is extracted).
– *Gold*.
– *Wolframite* (the metal ore used to produce *tungsten*).
– Their derivatives (the common derivatives being tin, tantalum, and tungsten).

Under the Conflict Minerals Rule, only the specifically enumerated conflict minerals and their "3T derivatives"—tantalum, tin, and tungsten—are within the scope of the disclosure requirements. The Conflict Minerals Rule is focused exclusively on such materials that originate in the DRC or an adjoining country, which includes Angola, Burundi, Central African Republic, Republic of Congo, Rwanda, South Sudan, Tanzania, Uganda, and Zambia. Disclosure is only required for

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[1] "Artisanal" or "small-scale" mining is subsistence mining conducted by individuals or small groups of individuals working independently, typically with hand tools. "Small-scale" mining is more organized, often with a profit motivation, and semi-mechanized. artisanal and small-scale mining may occur seasonally or year-round. Up to 30 million persons are believed to engage in artisanal mining in over 70 developing nations.

[2] codified in pertinent part at 15 U.S.C. § 78m(p), 17 C.F.R. §§ 240.13p-1 and 249b.400, and SEC Form SD.

(1) publicly traded companies (2) for whom conflict minerals are necessary to the functionality or production of a product they manufacture or contract to manufacture.

Notably, under U.S. law there is no current restriction on the trade in these minerals, even if sourced in the DRC or an adjoining country. The sole purpose of the Conflict Minerals Rule is to require companies that must file reports with the SEC to make an annual conflict minerals disclosure. Accordingly, the rule is grounded on the notion that the adverse reputational effects of a company using conflict minerals sourced in the DRC region that cannot be shown to be conflict-free will encourage companies subject to the rule to require that their mineral supply chains ensure there is conflict-free provenance going forward.

The Conflict Minerals Rule was designed to help address the negative humanitarian impacts of ongoing armed conflict in the DRC and adjoining countries by limiting funding to armed groups in those regions. According to a strategy document submitted by the U.S. Department of State and USAID to Congress in 2011, there are five objectives for addressing the connection between human rights abuses and the funding of armed conflict through exploitation of mineral resources in the DRC region: (1) promoting a role for local security forces, (2) enhancing civilian regulation of the trade in conflict minerals, (3) protecting artisanal miners, (4) improving regional and international efforts to address these issues, and (5) using public outreach to promote due diligence and responsible sourcing. These stated goals and objectives essentially boil down to a single comprehensive interest in bolstering and protecting the conflict-free mining industry in the affected regions, thereby improving the lives of those reliant on artisanal mining for their livelihoods while improving regional stability.

Utilizing a disclosure rule grounded primarily on reputational compulsion was thought to be a preferable approach to the problem of conflict minerals, as opposed to an alternative measure such as the imposition of sanctions for the use of conflict minerals sourced from the DRC region, which would almost surely have precipitated an embargo of the region. However, as even the most ardent supporters of the Conflict Minerals Rule would agree, it is simply unrealistic to expect that a disclosure rule alone will be able to accomplish the objectives behind it. Instead, it must be one part of a broader commitment by industry, governmental, and non-governmental actors to tackle the complex issue of conflict minerals in a comprehensive and sustainable fashion. To that end, public, private, and civil society players have been creating a bigger support structure to ensure the Conflict Minerals Rule achieves its goal; one example is the Public Private Alliance for Responsible Minerals.[3] Yet, in spite of such efforts, as will be discussed in more detail below, it is not clear that the Rule will be able to successfully avoid precipitating the de facto embargo it was intended to avoid, even without negative disincentives against companies subject to it

2.1.2 *Year One Disclosure Analysis*

Based on analyses of the filings made in year one, several industries are heavily affected by the Conflict Minerals Rule, with a healthy mix of U.S. and non-U.S. companies finding themselves within scope of the disclosure requirement. Over half of the filings were made by companies in the consumer and industrial products industries, with another 30% in the technology, media, and telecommunications industries. Life sciences and healthcare companies accounted for another 11% of filings, with 4% in energy and resources, and 1% in financial services. Not surprisingly, 86% of filers were U.S.-headquartered companies, with 14% of filers headquartered elsewhere (primarily in Europe, which accounted for 10% of filers).

Although the SEC expected nearly 6,000 companies to file disclosures under the Conflict Minerals Rule, only 1,315 did so. It is not yet clear whether this represents an overestimate by the SEC, spotty participation by companies subject to the Rule's disclosure requirements or some combination of the two. Of the 1,315 companies that did file disclosures, approximately 77% (over 1,000) included a conflict minerals report, meaning that a reasonable country-of-origin inquiry did not provide a basis for asserting that the company's conflict minerals did not originate in the DRC or an adjoining country or did come from scrap or recycled sources; or that the company had no reason to believe that its conflict minerals may have originated in the DRC or an adjoining country or may not be from scrap or recycled sources.

Perhaps most critical to assessing the impact of the Conflict Minerals Rule, the large majority of filers either expressly or implicitly indicated that they were unable to determine the origin of their conflict minerals such that they could not determine whether they were DRC conflict-free. Although this is surely an indication of teething troubles as industry establishes the internal due diligence protocols necessary to make definitive determinations as to conflict mineral origin, it is also indicative of the structural issues with transparency and traceability that exist upstream from the reporting companies and could take a significant amount of time to resolve. Many companies have reported just such traceability hurdles, including the simple challenge of securing adequate responses to due diligence inquiries

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[3] See http://www.resolv.org/site-ppa/.

from their supply chain. One SEC estimate is that 278,000 suppliers not subject to the Rule are indirectly affected by it, demonstrating the scope of the due diligence challenge facing reporting companies.

2.2 *Assessing the Impact of the Conflict Minerals Rule of Dodd-Frank*

As indicated above, the most harmful impact of the Conflict Minerals Rule would be inadvertent creation of a persistent de facto embargo of conflict minerals from the affected regions and potentially the African continent as a whole. Based on evidence gathered during the embargo imposed by DRC President Kabila in North Kivu, South Kivu, and Maniema in 2010–2011, and according to various other reports, such an embargo would cause economic collapse in communities reliant upon mining both directly and for indirect support of secondary businesses.[4] The embargo issue presents a particularly acute problem because of the disproportionate impact it would have on small miners who are typically less able to adhere to and satisfy supply chain due diligence requirements. The result could in fact exacerbate the harm the Conflict Minerals Rule is seeking to address by increasing smuggling, weakening governance, and depressing prices for ore. Together, these factors make the violation of human rights even more likely.

It has been reported that following passage of the Dodd-Frank Act but prior to adoption by the SEC of a final Conflict Minerals Rule, many companies within scope of the Rule began to sharply decrease or altogether cease sourcing conflict minerals from the affected region and indeed Africa. This was out of apparent concern over the difficulties in being able to comply with due diligence and traceability requirements under the Rule, and compounded by a mining ban imposed by President Kabila on three provinces in eastern DRC between September 2010 – March 2011. While the final form of the Rule and experience with its requirements may lessen that risk aversion over time, it would be naïve to expect companies to take on unnecessary risk and expense. It is also costly to re-enter markets from which one has disengaged, particularly where the trading landscape includes new ways of doing business, which may also serve as a disincentive. As a result, several factors converge to make a persistent de facto embargo an increasingly likely outcome of the Conflict Minerals Rule in the current global supply environment.

First, although artisanal mining is a critical industry in the African Great Lakes region, that region is not necessarily a critical supply for the covered conflict minerals.[5] At least 2 million artisanal miners extract conflict minerals in the affected region, making it a vital contributor to rural economies in the DRC and adjoining countries. However, the relative availability of the covered minerals in other regions around the world combined with the challenges and expense of conducting due diligence and establishing traceability in the DRC region make it attractive for mineral supply chains to pivot away from the DRC and adjoining countries. Even where the DRC and its adjoining countries may be a more attractive source from a pricing perspective, due diligence costs could make the region a more expensive source as compared to lower risk areas.

Second, the Conflict Minerals Rule is due diligence-driven, but the industry and governmental infrastructure in the region lacks the sophistication or understanding needed for the concept to work.

A 2013 report issued by the OECD indicated that local governments in the DRC and adjoining countries currently lack the capacity to fulfill what is expected of them in ensuring responsible sourcing, including how companies are expected to implement due diligence requirements. This is exacerbated by limited funding for the programs, including for the personnel needed to certify, audit and monitor both the actual mineral supply chains, and the responsible sourcing initiatives that support their assurance, and the infrastructure necessary to support traceability and data management. For the in-region programs to function there needs to be a significantly higher number of independent auditors and

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[4] The most likely impact for trade in the 3Ts is bringing that economy to a halt, based on the relatively limited importance of the DRC, African Great Lakes Region and even Africa as a source of those minerals. However, this could have an even more pernicious effect in helping entrench an already robust black market in gold. These regions produce huge amounts of gold from artisanal and small-scale miners, (about 8 tonnes per annum in DRC) with artisanal gold mining serving as an important part of rural economies all over Africa. In fact, when President Kabila banned exports of 3TG in 2010–2011, the 3T economy collapsed but gold did not. Even today, without any effective traceability or due diligence system in place for gold in DRC or the African Great Lakes Region more broadly, DRC gold is being mined, traded, and sold at above market rates, indicating that criminal elements are already embedded in this regional economy and/or that buyers use gold as a financial instrument to avoid financial costs in their primary business. Accordingly, even if legitimate buyers shy away from the region, it can be assumed that gold will continue to leave the DRC and be laundered into legal supply chains elsewhere in the international market.

[5] <1% gold, <3% tungsten, <5% tin, <12% tantalum comes from DRC; <2% global mined gold production from artisanal and small-scale mining sources in the GLR; in Drangini, H. 2014: Going for Gold: Engaging the Jewelry Industry in Responsible Gold Sourcing in Africa's Great Lakes Region. Enough Project, November 2014. At: http://www.enoughproject.org/files/publications/GoingForGold-EnoughProject-Nov2014.pdf (November 26, 2014); USGS 2012: Minerals Yearbook 212 – Congo Kinshasa. At: http://minerals.usgs.gov/minerals/pubs/country/2012/myb3,-2012-cg.pdf (25 November 25, 2014); USGS 2014a: Mineral Commodity Summary Tungsten. At: http://minerals.usgs.gov/minerals/pubs/commodity/tungsten/mcs-2014-tungs.pdf (November 26, 2014); USGS 2014b: Mineral Commodity Summary – Gold. At: http://minerals.usgs.gov/minerals/pubs/commodity/gold/mcs-2014-gold.pdf (November 26, 2014); Levin, E. and R. Cook forthcoming, Etude comparative des systèmes de Certification et de Traçabilité en cours en République Démocratique du Congo (RDC) et dans le monde, en vue de proposer un système approprié aux besoins du pays et répondant aux exigences internationales for PROMINES.

mine monitoring officials than are currently available, as well as improved transparency and coordination. At present, many hundreds of mine sites that could be operating viably from a commercial perspective are unable to operate viably from a legal perspective because they have not yet been validated and/or have not yet had a traceability system established. Mine site validation and certification and the use of traceability are pre-conditions for legal business, in accordance with Congolese law.[6] Until this issue can be resolved, the likelihood of fraud in-country and illegal cross-border smuggling will remain elevated, with the potential to impact due diligence efforts outside the certification programs.

That leads to the third critical factor, which is the practical challenge of implementing conflict-free supply chains at the local level. Everything from the lack of resources noted above, to the imposition of punitive or otherwise poorly designed tax (and rent) structures with respect to legitimate mines creates ongoing incentives for illegitimate mining and trading activities and structural barriers for the legitimization of local mineral industries. Local government buy-in will be particularly important. Without it, in-region efforts will continue to stall and face only spotty success, while the status quo will persist, if not deteriorate, in the face of an increasingly reticent population of Dodd-Frank compliant purchasers of conflict minerals.

A persistent de facto embargo would have obvious immediate negative consequences for the overall viability of a conflict-free mining industry in the DRC region. Further, it is unlikely that a shift away from conflict minerals sourced in the DRC region by companies subject to the Conflict Minerals Rule would actually limit armed groups' access to funding via exploitation of mineral resources, especially of gold. Current indications are that smuggling of all types of conflict mineral from the region to smelters in countries with non-transparent supply chains is ongoing. Similarly, China has by far the greatest number of smelters of the covered conflict minerals—accounting for 82 of the 278 smelters of tin, tantalum, tungsten, and gold worldwide identified by the U.S. Government Accountability Office ("GAO") in a 2013 report—and a significant consumer of those same minerals. Chinese smelters have so far proven resistant to adoption of due diligence protocols designed to provide transparency and ensure conflict-free sourcing, making it exceedingly difficult for global supply chains to provide adequate assurances of conflict-free sourcing.

The tide is turning, however. In October 2014, the OECD and China Chamber of Commerce Metals, Minerals & Chemicals Exporters & Importers (CCCMC) signed a Memorandum of Understanding and are working on recommendations to operationalize the OECD Due Diligence Guidance for Chinese companies. [7]

2.3 *Solutions to the Problem*

In fairness to the architects of the Conflict Minerals Rule, it was never designed to succeed as a stand-alone solution to the problem of conflict minerals in the African Great Lakes region. Rather, it was intended to serve as a catalyst for and complement to in-region sourcing and certification programs, and industry-driven due diligence and traceability initiatives. Unfortunately, the Rule became operational before the necessary upstream due diligence infrastructure could be put in place and allowed to mature to a point that it is sufficiently extensive, reliable, and well-understood by industry and producer governments that it can be said to adequately complement the Rule's disclosure mechanism while protecting artisanal mining communities' interests. Accordingly, at this point the best way to ensure the ultimate success of the Conflict Minerals Rule—which to its credit has raised awareness and stoked industry action—is to ensure the success of the due diligence mechanisms that will support it, while also ensuring that stakeholders do not rely upon it as the primary way for either addressing the Congolese conflict or advancing good governance and improving operating conditions in the mineral sectors of DRC and its neighboring countries.

Among the most promising proposals and development efforts are the various certified production and trading partnerships currently under development in the region. The tools these proposals offer include independent monitoring systems at mine sites designed to ensure they prevent the worst human rights and business practice violations and ensure the absence of conflict funding. These systems would allow ore to enter the supply chain with a certification of conflict-free status supported by sufficiently transparent and credible provenance; some also, and have the potential to have immediate benefits to local populations in terms of safety, improved working conditions, and potentially improved pricing and corresponding investment by mining cooperatives in improved equipment. Accordingly, countries such as the United States and members of the EU that are committed to addressing the humanitarian crisis in the DRC region can best do so by encouraging the use of certification programs that enable conflict-managed sourcing from within the DRC region.

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[6] Decree No. 0058/CAB.MIN/MINES/01/2012; Decree No. 0057/CAB.MIN/MINES/01/2012.

[7] Kim, S. 2014 *Keynote Remarks by DAF Deputy Director Sangkyom Kim at Exploration Exchange China Conference, 24 October 2014*. At http://www.exploration-exchange.cn/presentation/kim.pdf. (June 12, 2014).

Some of the key regional and industry supply chain certification and due diligence initiatives currently in place or under development include the following:

(1) *International Conference on the Great Lakes Region ("ICGLR") Regional Certification Mechanism ("RCM"):*

– This regional mineral certification coordination system, being implemented by an inter-governmental organization of 12 central African countries, provides a system for domestication into national law by ICGLR Member States of a methodological framework for the national standards and procedures of mine site inspections, chain of custody (traceability) systems and export certification. It is one of the six tools provided within the ICGLR's Regional Initiative on Natural Resources ("RINR"). The commitment to implement both the RINR and the RCM was signed by ICGLR heads of state at a special summit in Lusaka in December 2010.

–To date the RCM has been domesticated in DRC and Rwanda, and is in process in Burundi. It is not yet fully operational in any of these countries, however, because essential components remain theoretical, such as the regional database or the Independent Mineral Chain Auditor who ensures overall system integrity at the sectoral level, or only partially developed, such as the third-party exporter audits which assure the integrity of an exporter's supply chains and business practices in line with the OECD Due Diligence Guidance, and so give meaning to the RCM export certificate granted to each mineral consignment (presently in use in DRC and Rwanda). Ultimately, the RCM should give downstream buyers of ore from the region sufficient assurances of conflict-free sourcing, while working in concert with other industry-driven programs.

(2) *The Certified Trading Chains ("CTC") Scheme:*

– The CTC was developed by the German Federal Institute for Geosciences and Natural Resources ("BGR"[8]), and is implemented by national authorities (e.g., in Rwanda and the DRC), with the support of BGR. It certifies that mine sites are "CTC-compliant." It involves third-party assurance of "trading chain traceability, transparency, and the ethical quality of mineral production . . . against a set of standards derived from international regulations such as the OECD Guidelines for Multinational Enterprises, Risk Awareness Tool," and anticipating the parts of the contents of the OECD-UN Guidance. With the focus on supply chain due diligence aspects and artisanal and small-scale mining good governance/responsible mining practice, it is more in keeping with triple bottom line expectations than the other conflict minerals standards because it incorporates more social and environmental considerations than required by either the OECD's Due Diligence Guidance or iTSCi (discussed below), for example.

(3) *International Tin Supply Chain Initiative ("iTSCi"):*

– iTSCi is a joint initiative between ITRI (acting as the iTSCi secretariat) in cooperation with the Tantalum-Niobium International Study Centre ("T.I.C.") and several countries in the African Great Lakes region. The program also has a memorandum of understanding with the ICGLR. It assists upstream companies of all scales and at all supply chain tiers from mine to smelter comply with the five steps of the OECD Due Diligence Guidance, as well as the recommendations of the DRC United Nations Group of Experts by expanding due diligence to include criminal networks, and sanctioned individuals and entities. iTSCi covers tin, tantalum, and tungsten ores (mineral concentrates), but not gold. Mineral exporters in the region wishing to participate in the iTSCi program need to become an official iTSCi member.

–iTSCi works through the operationalization of three components: (1) chain of custody tagging and monitoring of mineral origin (done in cooperation with government authorities in Rwanda and the DRC, based on memorandums of understanding and standard operating procedures), (2) on the ground assessment and monitoring of mine sites, transportation routes, companies, and the macro-level situation[9] to identify and manage conflict-related risks, including human rights abuses, and (3) independent third-party audit of all operators joining iTSCi, evaluation of the macro-level situation, and also the system data.

–iTSCi is intended to provide practical guidance that can be implemented down to the level of smaller cooperatives and artisanal mine sites. Although in development since 2008, iTSCi's expansion into key regions of the DRC has been held up due to various factors, including the exit of Dodd-Frank compliant buyers from the market. Implementation is happening in Katanga, Maniema, North Kivu, and South Kivu in DRC, in Rwanda where it is well developed and implemented largely by government, and in Burundi where it is just beginning. The iTSCi supply chains involve over 1,000 mine sites involving 80,000 miners in DRC and Rwanda.

(4) *Conflict-Free Smelter ("CFS") Program:*

– The CFS program, jointly initiated in 2009 by the Electronic Industry Citizenship Coalition ("EICC") and Global e-Sustainability Initiative ("GeSI"), offers smelters or refiners ("SoR") the ability to certify to buyers that they

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8 BGR comes from the German version of this name, Bundesanstalt für Geowissenschaften und Rohstoffe.

9 The scope of the macro-level risk assessments depends on the geographical scale. As an example: the macro-level risk assessment for Rwanda addresses the whole country, while for the DRC it is done at the provincial level.

supply conflict-free metals. CFS SoR must have adequate policies and procedures regarding conflict minerals, vet their sources of raw materials, and be re-reviewed on an annual basis. As noted above, if an applicant sources from the DRC or adjoining countries, it must be able to provide verified conflict-free chain of custody and traceability documentation for its entire upstream supply chain before it can become a CFS-endorsed supplier. As of November 2014, 120 smelters have been certified as conflict-free (up from 26 in mid-2013), with 48 more in the process of being certified. Although the number of worldwide smelters of conflict minerals is unknown, the GAO estimates it could be up to 500.

In addition, several other groups have or are developing similar or supplementary chain of custody certification programs, responsible sourcing guidance and conflict-free standards. Some larger smelters, manufacturers and interested governments are even taking the step of developing closed-pipe supply chains for covered minerals, meaning that a single company retains custody of the minerals through the entire (or majority of the) supply chain. Examples of the closed-pipe approach include Solutions for Hope, the Conflict-Free Tin Initiative and Kemet's Partnership for Social and Economic Sustainability' for conflict-free sourcing of tantalum. All of these initiatives have utilized iTSCi and CFS program smelters as part of their solution to ensure upstream traceability in particular. Other traceability initiatives have developed conflict minerals tracking, tracing and due diligence systems for markets in the African Great Lakes region, including the Better Sourcing Program, GeoTraceability, MetTrak, MineralCare and SERCAM. BGR has developed a different technological solution for enabling traceability through its Analytical Fingerprinting Project which offers a sampling system to identify the source of conflict minerals in cases in which a downstream company raises a red flag as to origin of a specific consignment.

Unfortunately, systems for enabling due diligence of gold supply chains are presently either vastly underutilized in-region, save for a few initiatives, or are under-developed. Partnership Africa Canada is an example of an effort to establish a responsible source of gold in Orientale province in the DRC in 2013. For various reasons the pilot was not continued, but lessons learned are informing plans for additional pilots in the African Great Lakes region. Neither the Fairtrade or Fairmined systems for certifying artisanal and small-scale gold supply chains is operational in the DRC, though Fairtrade is due to certify up to nine artisanal and small-scale gold mining organizations in Uganda, Kenya, and Tanzania in 2015. Some refiners are proactively seeking ways to source gold from the African Great Lakes region, using one of the range of refiner-specific standards that would enable this (e.g., the Responsible Jewelry Council's Chain of Custody Standard, the London Bullion Market Association's Responsible Gold Guidance, or the Dubai Multi-Commodities Center's Responsible Sourcing Protocol). Large-scale mines are presently the preferred origins for these buyers given their ability to exert sufficient controls to satisfy the recommendations of the OECD Due Diligence Guidance, and also the difficulty of entering local markets as an international buyer.

Ultimately, however, stakeholders remain extremely skeptical about the possibilities of scaling up responsible sourcing systems for gold in-region, given the common utilization of gold as a financial vehicle for enabling tax evasion and money laundering around the world, and especially in the economies under scrutiny. Breaking these links (which would be necessary to conform with the OECD Guidance) will require more than simply enabling due diligence of supply chains by downstream buyers, not least because gold continues to be mined, traded, and exported illegally with impunity in much of the African Great Lakes region and especially in the DRC.

However, there are now neither disincentives for avoiding sourcing from the DRC region nor incentives for using non-conflict DRC region sources. Without those kinds of positive or negative reinforcements, there is limited reason to expect companies subject to disclosure requirements to take on additional expense and administrative burden in order to source in-region, not least where sourcing in-region means building new types of supply chain and new initiatives, which is especially the case for gold. The EU has an opportunity to change that dynamic as it phases in its own conflict minerals rules over the next several years, and to learn from the experience offered by the first several years of disclosures under the Conflict Minerals Rule. As more countries adopt disclosure or other requirements designed to address conflict minerals, the industry, governmental, and non-governmental actors involved in supply chain due diligence efforts should find ample opportunity to further educate covered companies while continuing to implement and enhance due diligence infrastructure.

2.4 *Conclusion*

The Conflict Minerals Rule is an imperfect solution to an intransigent human rights issue. Although there is ample room for debate as to whether Congress should have attacked that issue in the manner that it did, the Rule is, for now, a fact of life for companies traded publicly in the United States. Accordingly, the key is not to look back but to look forward at how best to balance the noble goals of the Rule against the expense and inconsistency of the due diligence process it has precipitated. Only time will tell

whether there is a will to maintain the focus necessary to succeed where so many previous efforts have failed.

3 The European Commission's Proposal for an EU Regulation on Conflict Minerals Due Diligence

On March 5, 2014, the European Commission communicated to the European Parliament and the Council of the European Union (the two co-legislators of the EU) a proposal for a Regulation setting up an EU conflict due diligence scheme.[10] This short proposed Regulation (16 Articles), came together with a 14-page joint-communication of the Commission and the EU's High Representative of the European Union for Foreign Affairs and Security Policy providing some context and stating the policy objectives behind the proposal, an 86-page impact assessment document reviewing the various policy options that were opened to address the trade in conflict minerals (one of which was the solution proposed by the Commission in its draft Regulation), and a 134-page report prepared by a software and compliance consultancy specialized in supply chain management, which estimates the costs, benefits, and related effects of due diligence, and underpinning some of the findings in the impact assessment document.[11]

3.1 *Policy Objectives of the Proposed Regulation*

Typically, the policy objectives of an EU Regulation are set out in the Regulation itself, in recitals preceding its operative part (contained in the Articles). However, the recitals of the Commission's proposed Regulation are pretty uninformative in this regard, and the policy objectives must be found in the joint-communication of the Commission and High Representative, which contains a very detailed statement of the policy objectives behind the Commission's proposal.

In the joint-communication, the Commission and the High Representative explain that the objectives of the proposed Regulation are two-fold: (i) minimizing the risk of financing armed groups through the purchase of conflict minerals, while (ii) promoting the responsible sourcing of minerals from conflict areas. In the words of the joint-communication:

> The Commission proposal for a Regulation setting up a Union system for supply chain due diligence self-certification of responsible importers of tin, tantalum and tungsten, their ores, and gold aims to support EU companies exercising due diligence to help minimise the risk of financing armed groups. It also seeks to promote the responsible sourcing of these minerals from conflict and high-risk regions, in order to increase the volume of legitimate trade.

3.1.1 *The First Policy Objective: Minimizing Risks of Financing Armed Groups, through Due Diligence*

This first objective is to be achieved through a self-certification procedure created for importers (described under 3.2 below); which will in turn help the Commission (and the OECD) draw up a list of responsible smelters and refiners. This list of responsible refiners and smelters is at the heart of effective compliance, because the refining and smelting stages of production are the highest level in the supply chain past which point it becomes impossible to trace the source of the ore or metal (without cooperation from the refiner or the smelter).[12] There is only a limited number of smelter and refiners in the world.[13] By creating a reliable list of responsible refiners and smelters, the Commission hopes to increase the pressure on these refiners and smelters to perform due diligence themselves[14] and, in turn, facilitate the task of everyone else further down in the supply chain willing to source minerals responsibly (either because they want to, or because they are compelled to). This could also help solve the issue created by the presence in many supply chains of SMEs unable to perform due diligence themselves, and hindering the ability of everyone else downstream to complete effective due diligence.

The Commission is very careful not to add any extra burden on operators, by proposing measures that are primarily aimed at promoting and facilitating compliance with the OECD Due Diligence Guidance and

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[10] Proposal for a Regulation of the European Parliament and of the Council setting up a Union system for supply chain due diligence self-certification of responsible importers of tin, tantalum and tungsten, their ores, and gold originating in conflict affected and high-risk areas, COM(2014) 111 final.

[11] All available at http://europa.eu/rapid/press-release_MEMO-14-157_en.htm.

[12] The joint communication explains that "These operators are well placed to identify the origin of the purchased mineral. They are the last stage in the supply chain where it is still technically feasible to trace back the origin of minerals and can leverage responsible supply behaviour in producer countries. Existing due diligence initiatives recognize the value of working with responsible smelters."

[13] The Commission estimates that there are globally 120 gold refiners, and 280 smelters for the other three minerals (joint communication, at page 6).

[14] In its impact assessment, at page 25, the Commission explains that "EU downstream operators report the following challenges in collecting the required information from their suppliers to conduct due diligence under the present frameworks: first, identification of the smelters/refiners in their supply chain is a problem, and second, if and when identified, it is difficult to exert adequate pressure on the smelter/refiner so as to obtain the required information."

Dodd-Frank.[15] This is actually stated as a separate policy objective in the Commission's impact assessment: "improve the ability of EU downstream operators to comply with existing due diligence frameworks, including the U.S. Dodd-Frank."

The Commission means to facilitate compliance with the OECD Due Diligence Guidance by adopting rules that are very close to those of the OCED, by constantly referring to the OECD Guidance, and by providing for a cooperation mechanism between the Commission and the OECD.

Through its focus on refiners and smelters, it facilitates compliance with Dodd-Frank by creating a tool that makes it easier to identify the origin of the ores and metal. As the joint-communication puts it:

> An integrated EU approach to promote responsible sourcing needs to build on existing initiatives and support the uptake of the OECD Due Diligence Guidance. It should stimulate better compliance at the level of smelters, including outside the EU, and facilitate a better flow of due diligence information down the supply chain at relatively low cost.

The focus on smelters and refiners is seen as especially important by the Commission, which considers that "stronger engagement from the upstream side of the supply chain would help develop more efficient ways of conducting due diligence" and that "this is precisely where action at EU level is needed."[16]

The proposed Regulation is reviewed below under 3.2; where it will be explained that overall the Commission's proposal could significantly contribute to facilitating due diligence compliance by EU operators.

3.1.2 *The Second Policy Objective: Promoting the Responsible Sourcing of Minerals from Conflict Areas*

The promotion of responsible sourcing is placed by the Commission and the High Representative on an equal footing with the first objective of limiting the financing of armed groups through trade in minerals.

The joint-communication recognizes the shortcomings of Dodd-Frank when it comes to achieving this objective: "There are indications that this Act has worked as a deterrent to source minerals from the GLR [Great Lakes Region] regardless of whether the minerals are legitimately extracted or not." This, in turn, has a very negative impact on the situation in Eastern Congo and the Great Lakes Region as "The remaining 'conflict-free' minerals struggle to reach US or EU markets and are frequently traded at below market prices."[17] "Loss of trade means loss of local livelihoods in a setting where alternative employment opportunities are scarce, in particular in the case of artisanal and small-scale mining." The Commission's impact assessment further observes that "the probably unintended result is that DRC minerals continue to be exported, yet informally and at very low prices, to countries from which sourcing is considered conflict free."[18]

Beyond these adverse consequences of Dodd-Frank, the Communication also recognizes that there is today an absence of sufficient incentive for compliance, which explains why operators tend not to perform any due diligence: "Although the OECD Due Diligence Guidance provides a framework for action, current compliance efforts are fragmented and interested companies are offered limited incentives to act."[19]

This absence of sufficient incentives probably also explains why operators compelled to conduct due diligence by Dodd-Frank tend to prefer to disengage from the Great Lake Region, rather than invest in developing the practices and infrastructure necessary to source responsibly from the region. The Commission intends to address these issues by providing a series of "accompanying measures," that are not included in the proposed Regulation but in the joint-communication and are meant to incentivize responsible sourcing. The Commission means to create additional financial incentives to promote/support due diligence practices among downstream users; and to support demand from conflict-affected areas by facilitating the switching by EU operators to due diligence compliant smelters/refiners sourcing in those areas.[20] These incentives are addressed below under 3.3.

3.2 *Overview of the Proposed Regulation*

In Article 3 of its draft Regulation, the Commission proposes the establishment of a non-binding self-certification

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[15] Dodd-Frank affects many EU companies, either because they are listed in the U.S. and subject to the SEC's authority, or because they supply to U.S. listed companies. The Commission estimated that between 150,000 and 200,000 companies in the EU are involved in the supply chains of the 6,000 listed companies directly affected by Dodd-Frank.

[16] Page 30 of the impact assessment. [need complete citation].

[17] Between 30% and 40% lower according to the Commission's impact assessment (page 27). [citation form].

[18] Impact assessment report at page 29. [citation form].

[19] Joint Communication, at page 6.

[20] Impact assessment at page 31. [citation form].

procedure open to importers of tin, tantalum and tungsten, their ores, and gold:

> Any importer of minerals or metals within the scope of the Regulation may self-certify as responsible importer by declaring to a Member State competent authority that it adheres to the supply chain due diligence obligations set out in this Regulation. The declaration shall contain documentation in which the importer confirms its adherence to the obligations including results of the independent third-party audits carried out.

The supply chain due diligence obligations set out in Article 4 of the proposed Regulation are those of the model supply chain policy in Annex II to the OECD Due Diligence Guidance. The draft Regulation stresses the need for self-certified importers to communicate about their policy, to place the supply chain due diligence under the supervision of senior staff, to incorporate their supply chain policies in contracts with their suppliers, to establish a company-level grievance mechanism or recourse to external bodies such as an ombudsman, and ensure the traceability of the imported minerals and metals. In line with what the OECD Due Diligence Guidance provides, additional information is required when minerals and metals originate in conflict areas.

In Article 5, the proposal provides for the obligation to identify, assess, and respond to identified risks of contributing to conflict and the adverse impacts thereof. A responsible importer that does not disengage from conflict areas is required to consult with its suppliers and other stakeholders (including NGOs, international organizations, the government of the country concerned, and its local authorities) and to agree on a strategy to mitigate any risk of contributing to conflicts and their adverse effects. Under proposed Article 6, the importer's activities, processes, and systems must be certified by an independent third-party.

Proposed Article 7 provides that an importer willing to subject itself to the voluntary self-certification procedure will be required to communicate, to the competent authority of the Member States where it is established, information about itself, about the suppliers, smelters and refiners in its supply chain, and about its imports of the minerals covered by the Regulation (and the proportion of minerals coming from conflict areas).

On the basis of the information collected by the competent authorities of the Member States, and after consulting the OECD, the Commission will prepare, publish, and update a list of responsible smelter and refiners of the four minerals/metals (proposed Article 8). The Commission will specify whether these smelters source responsibly from conflict areas.

Application and enforcement of the self-certification scheme are entrusted to competent authorities to be designated by each Member State under Article 9, who are required to ensure the effective and uniform implementation of the Regulation. Compliance with the requirements of the regulation is ensured by ex-post checks of responsible importers, performed by the competent Member States authorities under Article 10. In cases of infringement, a notice of remedial action is to be issued by the competent Member State authority. Should an importer fail to take the necessary remedial action, it will be notified under Article 14 of the loss of its status of responsible importer, and the Member State authority will inform the Commission. Reports of the checks of importers' records and of the notices of remedial action issued must, under Article 11, be kept for a minimum of five years.

The draft Regulation, in Article 12, provides for the exchange of information between the Member States' competent authorities, with customs authorities, and with the Commission. The Commission will be assisted (and controlled) by a committee set up under the advisory procedure of Article 4 of the comitology Regulation[21] (proposed Article 13).

Each Member State will have to submit each year a report on the implementation of the Regulation. On the basis of these reports, the Commission will prepare its own report that it will communicate to the Council and the Parliament every three years. Article 15 proposes that the functioning of the Regulation is to be reviewed three years after its entering into force, and every six years thereafter.

3.3 *The Accompanying Measures*

The joint-communication lists a number of accompanying measures meant to achieve the Commission's second policy objective of encouraging the responsible sourcing of minerals from conflict areas. Some of these measures involve state-to-state dialogue, helping the countries concerned adopt adequate legislation, and foster good practices on the ground. As explained under 3.5 below, these steps are essential, but they are insufficient, because responsible sourcing should be driven by demand as well, and because avoiding high-risk and conflict-affected areas altogether will usually remain cheaper than having to invest in responsible sourcing there.

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[21] Regulation (EU) No 182/2011 of the European Parliament and of the Council of February 16, 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers, OJEU 28.2.2011, L 55/13-18.

The Commission recognizes this, and to achieve its second policy objective, lists five incentives meant to convince operators to invest resources for the identification and fostering of responsible supply chains in conflict areas.

Out of these five incentives, three are not directed at operators using tin, tungsten, tantalum, and gold at all, but are meant to improve the adoption of the proposed voluntary certification scheme by enabling businesses to participate. They are:

– the promotion of responsible practices by smelters and refiners, through support focused on capacity-building and outreach activities, targeting public authorities, the private sector, and civil society organizations;

– funding to promote the uptake of the proposed self-certification schemes with small and medium sized importers of metal and ores; and

– awareness raising through government-to-business networks, to facilitate the uptake of the EU 'responsible importer' certificate.

A fourth incentive is meant to give more visibility to the responsible practices and behaviors of operators, to make their products more attractive to responsible consumers: publicizing letters of intent by private operators announcing commitments to source responsibly from conflict areas.

Only one of the five incentives proposed by the Commission could actually be described as a financial incentive, meant to increase the attractiveness for market operators of responsible sourcing: the Commission explains that its purchases of products containing tin, tantalum, tungsten, and/or gold, which have to be made through public procurement (government contracts), will be reserved to operators respecting the OECD Due Diligence Guidance. It is also calling on Member States to adopt similar rules for their own public procurement markets. Interestingly, it is the only measure proposed by the Commission that is addressed at manufacturers of products containing the four metals. All the other measures are primarily addressed at importers, and indirectly at smelters and refiners.

3.4 *Major Differences with Dodd-Frank*

3.4.1 *Voluntary Scheme*

The current Commission proposal is for a voluntary scheme, under which importers in the EU of tin, tantalum, tungsten, their ores, and gold would be permitted to self-certify that they have conducted due diligence in line with the requirements of the OECD Guidance. Dodd-Frank is mandatory. But it seems that the voluntary nature of the scheme is conditional upon importers submitting to the scheme voluntarily. Indeed, the joint-communication explains that the scheme will be evaluated after three years, and could become mandatory, *"if appropriate and on the basis of a further impact assessment,"* i.e., if the voluntary uptake is considered to be too low.

3.4.2 *Open to Importers Only*

Whereas Dodd-Frank applies to all companies listed in the United States, in all industrial sectors, the Commission's proposed Regulation is addressed only to importers of the covered metals and ores. According to the Commission, there are around 300 EU traders and around 20 smelters/refiners importing tin, tungsten, tantalum ores, and metals and gold, and more than 100 EU component manufacturers importing derived metals.[22] The proposed scheme is only opened to these 500-odd companies.

It is not possible for any other types of company (for instance a responsible manufacturer of electronic devices) to self-certify under the proposed scheme. This seems to show that the primary objective of the Commission's proposal is not so much to create its own conflict minerals rules, as is to make it easier for EU companies to comply with the requirements of existing rules (and primarily Dodd-Frank).

3.4.3 *Geographical Scope: All the Conflict or High-Risk Areas of the World*

Like the OECD Guidance on due diligence, but unlike the U.S. Dodd-Frank, the EU does not target any specific region of the world. The proposed Regulation targets "conflict-affected and high-risk areas" which are defined 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." The Commission does not provide for any mechanism to list and delist specific areas, similar to what it proposes to create for smelters and refiners. Certainly because it does not want to stigmatize any region of the world, maybe for fear that it could create a de facto embargo as Dodd-Frank did, more likely because it is easier politically.

There is no doubt that a list of high-risk and conflict-affected areas will arise in time, as operators will need a list to know what type of due diligence measures they need to take to source their minerals in a given area (should they not source in that area, or buy only certified

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[22] Joint-Communication at page 6.

products if available, or can they buy freely). Surely, metals originating in Switzerland are fine, and metals from North Kivu are not without certification. But what about metals from Angola, the Central African Republic, Afghanistan, and Pakistan? Operators may have very elastic views of what is a conflict or high-risk area, depending on whether they source in a region or not.

It seems to the authors that in the Commission's system the role of third-party certifiers[23] could be essential in drawing the list of the high-risk and conflict-affected areas. Third-party certifiers will indeed be unlikely to approve self-certifications of operators sourcing in areas generally recognized as being high-risk or conflict-affected areas. And with a negative audit, the competent Member State authority is likely to withdraw an importer's status as responsible importer.

Once this list of high-risk or conflict-affected areas has been drawn, the countries in this list will be stigmatized quite likely in exactly the same way Congo, the Great Lakes Region, and even Africa as whole, are stigmatized by Dodd-Frank today.

3.5 *Critical Review of the Commission's Proposal*

The Commission's proposal is quite strong on its first policy objective, by focusing its measure on the link in the supply chain that is the most problematic when carrying out due diligence: smelter and refiners. In this respect, the Commission's proposal should be a very welcome addition to the existing initiatives and regulations trying to end the financing of war groups through the trade in minerals. However, the Commission is much more timid on its second objective: to incentivize the utilization of responsible minerals from conflict-affected or high-risk areas.

3.5.1 *Where Are the Incentives?*

Sourcing minerals responsibly from high-risk and conflict areas requires commitments and resources far beyond what is required to ensure that no conflict minerals are present in products. The absence of conflict minerals can be achieved by disengaging from high-risk regions, which is what almost all responsible manufacturers have done as a response to Dodd-Frank.

Ensuring the presence of responsible minerals in the supply chain requires having at one's disposal certified minerals. And because there is preciously little of it,[24] having access to some responsible minerals will require involvement in, and support of projects on the ground.

There exists today entirely private initiatives, such as the Motorola Solution for Hope, seen by the Commission as one of the significant – albeit insufficient – schemes present in high-risk areas.[25] Needless to say, creating this type of certification programs costs significant amounts of time and resources.

In its assessment report, the Commission estimates the cost of due diligence per company to be "around €13,500 while recurrent costs are estimated at €2,700."[26] It is apparent from the annexes to this report that this estimate is entirely based on the use of compliance software of a type proposed by the consultants who prepared the report attached to the Commission's proposal and underpinning its impact assessment document.

In view of the costs incurred by companies subject to Dodd-Frank,[27] it is clear that the Commission's estimate is far too low. Furthermore, the steps required to comply with Dodd-Frank, requiring them to keep track of the various raw materials entering their supply chain and of their origin, do not touch the ground work necessary to make certified minerals available in the first place. And this key element in the responsible sourcing of minerals will never be cheap: it is not possible to ensure effective due diligence meant to keep operators engaged in high-risk regions without a significant amount of time, resources and money being spent on such initiatives, either by the public sector, by the private sector, or more likely by both.

Some operators may do this without any other incentives than their own sense of what is good and wrong, or consumers demand for products free of conflict minerals.[28] But most operators will not invest in

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[23] Who will probably communicate with the OECD, the Commission and the EU Member State where they are established, among other stakeholders.

[24] The Commission notes at page 29 of its impact assessment report that "*Presently, an insufficient number of mines are OECD compliant which requires more capacity: more mines need to have traceability systems in place so as to allow for OECD-compliant exports.*" The authors add that there is no traceability system for gold presently operational that is scaleable. MineralCare is a contender, as is GeoTraceability and MetTrak, but their coverage in DRC and the Great Lakes Region—the hub of focus for conflict minerals initiatives—is minimal.

[25] Impact assessment report, at page 27. Since the Commission released its proposal, the Motorola Solution for Hope is no longer operational in Katanga. Instead they have started Solution for Hope North Kivu, buying ore from Société Minirère de Bisunzu (SMB - formerly Mwangachuchu Hizi International - MHI) from a mine in Rubaya, Masisi Territory, North Kivu, and DRC.

[26] Impact assessment report, at page 47.

[27] See http://www.payson.tulane.edu/news/new-study-gauges-corporate-resources-mobilized-comply-conflict-mineral-disclosure-law: "*Issuers each invested an average of $545,962 worth of time and effort to comply with the law, the value of each company's conflict mineral program largely comprised of in-house corporate time, external human resources, an IT evaluation and IT system expenses.*"

[28] As the Commission puts it: "unquantifiable externalities which can be used for marketing purposes such as public image, Corporate Social Responsibility (CSR) and consumer satisfaction." Impact assessment report, at page 47.

responsible sourcing of this type without strong incentives. The Commission recognizes this in its assessment report, when it explains that 40% of European consumers surveyed in 2010 "are willing to pay more for products which help the environment, respect social standards, help developing countries or which are made in their countries."[29] This is certainly significant, but what is striking from this figure is that 60% of Europeans will not pay more for 'responsible' products. And one should expect that companies supplying products to these consumers will not care either whether the products they manufacture or import include conflicts minerals or not. What will matter to these companies and their customers is the price of their raw materials, and of the products they sell or buy. And chances are that using gold and metals made from ores originating in high-risk and conflict areas will mean for part of the market (the biggest part) cheaper products that sell better. For such operators, perhaps the majority, other incentives are needed.

The most effective incentive is certainly making the scheme mandatory under threat of sanctions, as the experience of Dodd-Frank has shown. While the Commission stresses that there are non-regulatory drivers of compliance, such as corporate social responsibility policies, image, and consumer demand, it recognizes that the main driver for compliance so far has been Dodd-Frank: half of the companies who responded to the Commission's consultation said that they are interested or compelled to exercise due diligence, while only 12% of the listed companies in the EU not subject to U.S. legislation made any reference to conflict minerals on their web site. The impact of Dodd-Frank on due diligence adherence is therefore very clear. What made operators move is the requirement to perform due diligence, under the threat of sanctions.

However, the problem with this approach is that sanctions mean disengagement. Indeed, compliance in the face of a threat has as a consequence that operators turn away from the risk, and lead to de facto embargoes, as witnessed with Dodd-Frank.[30]

The risk of complete disengagement from high-risk areas seems to be very real because the world today seems able to do without gold, tin, tungsten, and tantalum from these regions. According to the Commission's impact assessment report, conflict areas, and the African Great Lakes region in particular, seem to be the source of only a fraction of today's output of tin, tungsten, and tantalum ores. Based on the Commission's impact assessment,[31] only 2.4% of tin, less than 1% of tungsten, around 1% of tantalum would originate in Eastern Africa, and none in other conflict areas. The situation is similar for gold.[32]

If the objective of the Commission and the EU's co-legislators is to keep economic operators engaged in difficult high-risk regions, the incentives will have to be positive ones, i.e., financial incentives equivalent to the cost involved in developing certification procedures on the ground and remaining engaged in regions where doing business is difficult because of nearby conflicts. As reviewed above, the commission's so-called incentives are for the most part measures aimed at increasing the number of importers voluntarily subscribing to the self-certification scheme. One measure is aimed at providing informal support (not in the proposed Regulation) to the publicizing of the commitments of the downstream industry to source minerals responsibly, something 60% of consumers do not care about. Then there is the Commission's commitment to limit access to (Commission) public procurement markets to manufacturers who conduct due diligence of their supply chain in accordance with the OECD Guidance.

The Commission's proposal in its current draft has therefore only one incentive: reserving its public procurement markets to responsible operators. It is doubtful that a material number of companies would reorganize their supply chain in any meaningful way, let alone invest in certification programs on the ground, simply to have access to the Commission's markets for supplies. It is therefore fair to forecast that this proposed incentive would have no noticeable impact on the behavior of companies.

On the contrary, the Commission's proposal could actually make the current situation worse, by extending the de facto embargo that Dodd-Frank created against East Africa to exports of ores and metals to the EU (in addition

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[29] Assessment report, at page 49.

[30] The Commission is fully aware of this, and explains that "there is a risk that without addressing the market distortion, most of the extra due diligence thus generated could amount to "green washing", with operators meeting corporate social responsibility goals without sourcing in conflict-affected areas." Page 61 of the impact assessment report.

[31] (page 18). The Commission's impact assessment does not give the sources of these statistics of metal production. It should be noted that other sources suggest very different levels of production: <1% gold, <3% tungsten, <5% tin, <12% tantalum comes from the DRC; in Drangini, H. 2014: Going for Gold: Engaging the Jewelry Industry in Responsible Gold Sourcing in Africa's Great Lakes Region. Enough Project, November 2014. At: http://www.enoughproject.org/files/publications/GoingForGold-EnoughProject-Nov2014.pdf (November 26, 2014); USGS 2012: Minerals Yearbook 212 – Congo Kinshasa. At: http://minerals.usgs.gov/minerals/pubs/country/2012/myb3-2012-cg.pdf (November 25, 2014); USGS 2014a: Mineral Commodity Summary Tungsten. At: http://minerals.usgs.gov/minerals/pubs/commodity/tungsten/mcs-2014-tungs.pdf (November 26, 2014); USGS 2014b: Mineral Commodity Summary – Gold. At: http://minerals.usgs.gov/minerals/pubs/commodity/gold/mcs-2014-gold.pdf (November 26, 2014); Levin, E. and R. Cook forthcoming, Etude comparative des systèmes de Certification et de Traçabilité en cours en République Démocratique du Congo (RDC) et dans le monde, en vue de proposer un système approprié aux besoins du pays et répondant aux exigences internationals, for PROMINES.

[32] The impact assessment report does not give the share of gold coming from Eastern Africa or high-risk areas. Our own assessment gives a share of around 0.5% of the global gold production: Global gold supply from mine production was 3,054 tonnes in 2013 according to the World Gold Council's statistics (WGC 2014 'Gold Supply And Demand 3Q14' at http://www.gold.org/supply-and-demand/gold-demand-trends/back-issues/gold-demand-trends-q3-2014. DRC: production is estimated at around 8 tonnes per annum from artisanal sources. Source: CBRMT, 2014. and LSM production is about the same, based on an increase in production at the Kibali mine of around 7 tonnes. So a total of around 16 tonnes per annum. (See GFMS Gold Survey 2014 at http://bit.ly/1J9BfFq p. 20).

to exports to the U.S.) and by affecting other regions of the world untouched today by Dodd-Frank.

3.5.2 *Why Not Open the Voluntary Self-Certification Scheme to the Downstream Part of the Supply Chain?*

The impact assessment report notes that it is impossible today to establish the share of conflict minerals incorporated into semi-finished and end products imported into the EU, because of a lack of available data. But the Commission suspects that the share is significant, citing as an example the fact that 17% of China's tantalum ores originates in the DRC and Rwanda, and that the value of Chinese tantalum capacitors imported into the EU in 2011 was EUR 40 million. As the Commission puts it "In all cases, a proportionate share of imports can be expected to have originated in the DRC and Rwanda," although "trade statistics do not reveal the exact extent to which minerals from the DRC and Rwanda enter the EU market through the various products."[33]

The lack of available data is therefore an obstacle to the identification of the trade in conflict minerals incorporated into semi-finished and end-products, which in turn is an obstacle to putting an end to, or at least limiting imports of such products into the EU.

It is therefore all the more surprising that the Commission's self-certification scheme, which is voluntary, should be limited to importers of ores and metals. Opening it to other companies in the downstream part of the supply chain would appeal to some companies sensitive to the issue today who would be willing to capitalize on the increased visibility that the Commission's scheme would provide. The data provided by these companies could then be used by the Commission to better understand the supply chain of those downstream manufacturers, and adjust its policies accordingly.

3.6 *Conclusion: The Need to Create a Market for Responsible Minerals from Conflict and High-Risk Areas*

In its impact assessment report, the Commission seems to consider that the only alternative to due diligence for importers (whether mandatory or voluntary) range from: (1) adopting a non-binding recommendation (most ineffective), (2)adopting a system similar to Dodd-Frank for listed companies, or (3) making due diligence mandatory for all (importers and further down the supply chain) and banning products for which no due diligence was conducted or that incorporate conflict minerals. According to the Commission, the latter option would require *ex ante* border controls and setting up an international agreement at multilateral level, something that "requires a lengthy process with an uncertain outcome."[34]

These last two mandatory options reviewed by the Commission (a Dodd-Frank imposition of due diligence on listed companies, or an import ban) contain no measure meant to incentivize involvement of operators in the responsible sourcing from high-risk or conflict areas. Such solutions, if adopted, would therefore very likely result in even higher levels of disengagement, commensurate with the number of operators targeted by these mandatory requirements.

Whether these solutions are ultimately adopted by the EU's legislators, now or later (for instance upon revision of the scheme initially adopted), the Commission, the Council and the Parliament will have to tackle the issue of disengagement, and the need to provide meaningful incentives to operators.

One such incentives could be to reduce the level of customs duties for responsible products (metal and ores, as well as products incorporating a certain quantity of these ores and metals), through new autonomous concessions tailored to the specific policy objectives of the EU's conflict minerals policy, or by modifying the EU's existing Generalized System of Preferences to take into account this new policy objective (for instance by limiting the GSP+ status to products demonstrated to have undergone due diligence in line with the requirements of OECD Guidance).

Some of this could be done unilaterally by the EU (within the framework of the enabling clause[35]) without it being necessary to obtain the agreement of the other WTO Members. Some of it may indeed require obtaining the agreement of the other WTO Members. But if the EU is serious about implementing an effective conflict minerals policy that does not result in the de facto embargo of high-risk and conflict-affected areas, it should start talking to the other WTO members so that the necessary incentives can be introduced.

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[33] Impact assessment report at page 20.

[34] Impact assessment report, at page 39.

[35] The 1979 Decision of the then GATT members to allow derogations to the most-favored nation (non-discrimination) treatment of GATT Art. 1 in favor of developing countries.