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The EU draft law on conflict minerals due diligence: a critical assessment from a business & human rights standpoint

Background

On the 5th of March 2014, the European Commission proposed a responsible trading strategy for minerals from conflict zones.

The proposal took place within a specific and timely context. As IPIS has long documented, the exploitation of natural resources can have adverse human rights impacts. Businesses operating in conflict-affected or fragile regions should therefore ascertain whether their direct operations or their business relationships with other parties, including through their supply chains, have fueled or funded conflict and/or human rights abuse.

Notably, the global community has become increasingly concerned by the role that "conflict minerals" (tin, tantalum, tungsten and gold, also known by the acronym 3TG) have played in ongoing civil strife in the Democratic Republic of Congo (DRC). Recent years have seen the passing of both binding and voluntary measures at the global, regional and national level to address the conflict minerals problem.

In the United States, 2010 saw the adoption of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank). Section 1502 of the Act requires companies to publicly disclose whether any of the minerals in their products originated in the Democratic Republic of the Congo or an adjoining country. Companies that have purchased minerals originating from 'covered countries' (i.e. Great Lakes countries) are required to provide a report describing (amongst other matters) the measures taken to exercise due diligence on the source and chain of custody of those minerals.

An interesting element of the rule is that Dodd-Frank due diligence was adopted within a securities law framework, rather than as a trade or foreign policy measure. This sends out the powerful message that human rights risks and conflict due diligence are material for investors. Dodd Frank is a financial instrument, and as such its Section 1502 targets 6,000 businesses of different sizes and active across different industry sectors that are listed with the US Securities and Exchange Commission (SEC).

Dodd Frank Section 1502: April 2014 update

At the time of writing, the US Court of Appeals for the District of Columbia Circuit had just issued a ruling that rejected legal challenges put forth by industry groups arguing that the regulation was 'arbitrary and capricious'. However, the Court did concurrently find that the requirement that issuers label their product 'conflict-free' constitutes as a violation of the First Amendment's right to free speech.

Global Witness filed an amicus brief to the Court, arguing that factual disclosure of conflict and human rights information is key for investors and consumers who seek to assess what kind of due diligence companies actually carry out.

As things now stand, since the Court did not vacate the rule, issuers are still required to submit their first reports to the SEC. With the filing deadline approaching (May 31, 2014), US consulting firm PrincewaterhouseCoopers LLP (PwC) asked nearly 700 stakeholders about their compliance preparation, progress, and challenges. PwC found that even if many companies are still in the early stages of compliance, almost half of respondents are pushing for high standards in responsible sourcing and have plans to become entirely conflict-free.

2010 also saw the publication of the standard-setting OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (OECD Guidance), with a supplement on tin, tantalum and tungsten. In 2012, the OECD adopted a second supplement concerning gold. The Guidance describes due diligence as a process, articulated in five clear steps that help companies respect human rights and avoid contributing to conflict through their sourcing practices. The OECD's five-step framework for risk-based due diligence is structured as follows:

Establish strong company management systems (including the adoption of a due diligence policy) and record keeping, including through chain of custody tracking and/or traceability systems

Undertake individually, or in cooperation with your customers, a risk assessment of your supply chain

Design and implement a strategy to respond to risks arising in your supply chain

Carry out independent, third-party audits of smelter/ refiner's due diligence practices

Report annually on your due diligence efforts and make the report available at your offices and on your website

Shortly after adopting the Guidance and the 3T Supplement, the OECD launched a pilot implementation phase on how companies implement due diligence in their 3T supply chains. Although the OECD Guidance is global in scope, the pilot implementation was carried out with a strong focus on the Great Lakes region. In 2011, IPIS was contracted by the OECD to assist upstream companies (in-region mining, trading and exporting companies) with the implementation of the Guidance and the Supplement.

Over two years and three reporting cycles for 67 upstream companies, a space was created for upstream players to share best practices, tools, and methodologies for implementing the Guidance. Business for Social Responsibility (BSR) carried out parallel work assisting downstream players (30 companies and four 3T industry associations) with due diligence operationalization.

Cleaning up 3TG supply chains: the OECD Guidance as a globally recognized standard

Numerous public and private initiatives that aim at severing the linkage between natural resources, conflict dynamics and human rights abuses have taken the OECD Guidance as a benchmark:

- In an accompanying ruling to Dodd Frank Section 1502, the SEC referred to the OECD Guidance as a credible due diligence standard for compliance with the law.
- The UN Security Council endorsed due diligence steps that are almost identical to those set out by the OECD.
- Domestic legislation adopted in the DRC and Rwanda requires all mining companies and minerals traders active within their jurisdictions to comply with OECD due diligence standards.
- The International Conference on the Great Lakes Region (ICGLR), an intergovernmental organization bringing together the twelve African Great Lakes countries, has produced a regional certification scheme requiring traders to undertake OECD due diligence before being issued a certificate.
- Industry initiatives (for example the Conflict-Free Smelter Program for the electronics industry, and the London Bullion Market Association's Responsible Gold Guidance) have developed additional guidance materials to help companies align their operations with the OECD Guidance.

After Dodd-Frank was adopted and while the OECD pilot project was being rolled out for global 3T supply chains, the European Parliament passed a resolution on failures in the protection of human rights and justice in the Democratic Republic of Congo. In this resolution, they welcomed the US conflict minerals law, "ask[ing] the Commission and the Council to examine a legislative initiative along these lines."

Since these early calls, the EU has undertaken a public consultation, further in-depth consultations, and an impact assessment on a possible Regulation on conflict minerals. Meanwhile, the EU was pressured by the public into following in the US's footsteps. In September 2013, a coalition of 59 NGOs made the case for binding EU legislation, saying that the EU should mandate companies to meet, at a minimum, the international standards endorsed by the OECD due diligence framework.

When EU Trade Commissioner Karel De Gucht presented the strategy on 5 March, he declared that it would meet the EU's responsibility to ensure that the 'global trade in goods' also leads to 'good trade', meaning 'responsible' trade.

Yet, despite the expectation and time surrounding the EU's approach to conflict minerals, when the Regulation was proposed, it was met with disappointment and criticism from many in the international community.

A closer look at the proposed EU Regulation

Critics (in particular EU campaign groups) contest that the proposed conflict minerals Regulation fails to create a real demand for conflict-free minerals in the EU. In short, the Regulation sets up a voluntary process through which importers of 3TG into the EU can self-certify that they do not contribute to financing armed conflict. If importers opt in, they have to conduct due diligence in accordance with the OECD Guidance.

By March 31 of the year after the rule comes into force, those EU importers that are part of the scheme will have to report their findings to the EU. Moreover, in accordance with Article 8 of the Regulation, the EU will then publish a list of "responsible smelters and refiners", to be updated annually with the help of the OECD Secretariat. The stated aim of this list is to raise both the level of public accountability regarding supply chain due diligence practices, and the level of compliance of EU and global smelters and refiners. EU officials have also stated that the list would provide downstream purchasers of metals with a clear tool to successfully identify and engage responsible smelters or refiners.

The EU Regulation: key features

The proposed Regulation creates a new, voluntary EU system for supply chain due diligence self-assessment.

It focuses on the upstream portion of the supply chain of 3TG, specifically targeting the roughly 400 importers of minerals into the EU.

It draws upon the OECD experience and pilot implementation projects, setting out due diligence steps that mirror the OECD Guidance.

It offers concrete incentives to companies that opt in/ accept to undertake the due diligence steps. These incentives range from public procurement contracts to funding possibilities for small and medium enterprises

It is global in scope, unlike Dodd-Frank, which focuses only on the African Great Lakes region.

This Commission proposal will now to be examined by both the European Parliament and the Council, who will need to agree on the final text. Labeled as fluffy – 'neither fish nor fowl', in the words of the Green MEP Judith Sargentini (who is also the Parliament's rapporteur on the conflict minerals file) – the current text is likely to be met with fierce resistance from MEPs, many of whom wished for much tougher Regulation.

But what are the elements that really make the EU's proposal inadequate?

The following takes a closer look at the Regulation's stated objectives, at its realistic deliverables and at how (or even if) it fits within the broader human rights due diligence context. One problematic issue, namely the voluntary nature of the proposed due diligence scheme, is presented and discussed. Two positive features are also highlighted, namely the global geographical scope of the Regulation, and the emphasis on public procurement policies as the 'stick' element in a proposal that is said to be all 'carrot'.

- **Lowering the bar**

The most controversial feature of the Regulation is that it does not require legal compliance**.** The message sent out by this voluntary system for supply chain due diligence self-certification is that even importers that do not opt in will still be able to access the EU market – a market currently representing 25% of the global trade in 3Ts and 15% in gold.

EU officials reportedly said that companies would opt in as a result of feeling under pressure from 'public scrutiny', emphasizing that compliance would involve "a kind of self-transparency, looking in the mirror and putting pressure on yourself because the media could point a finger and say why is company X on board and not you".

However, one cannot fail to notice that the UN Group of Experts on the DRC has been reporting on the connection between the minerals trade, armed conflict and gross human rights abuses for over a decade – as have Global Witness, the Enough Project and other campaign organizations. By contrast, companies generally only started to take a closer look at what was going on in their supply chains stretching into Central Africa after the passing of Dodd Frank.

EU officials have argued that they wanted to distance themselves from the "unintended consequences" of Dodd Frank, pointing out that in a bid to avoid litigation US companies now spurn traditional minerals sources around the Great Lakes region in favor of sourcing from developed countries like Canada.

Queried on whether Dodd Frank 1502 only brought more trouble to the already chaotic Congolese economy, IPIS has always highlighted that the argument depicting the US law as an external force disrupting local economies, social fabrics and forcing artisanal miners into unemployment, lacks essential nuance.

The on-the-ground impacts of what the Congolese call "Obama's Law" were investigated in detail by IPIS in 2013. Here, our team uncovered various drivers behind the adversities experienced by the Congolese artisanal mining sector over the past four years, ranging from draconian measures adopted at the national level (i.e. the 2010 presidential ban on mining activities) to broader CSR concerns that – Dodd Frank or not – led large producers to turn their backs on conflict-affected Congo.

Thus, it does not seem possible to clearly ascertain what can be attributed to Dodd Frank and what to other factors, and it is legitimate to cast doubt on some of the more aggressive anti-Dodd Frank assertions that have been made by EU officials, amongst others. .

While it might be true that some companies avoid sourcing from covered countries to ease compliance requirements under Dodd Frank, it is also true that others have recognized that shying away from the Great Lakes would just cause more hardship for the artisanal and small-scale miners of the DRC, and took the bold decision of re-engaging with in-region suppliers.

Several large companies listed on the US stock exchange actually started going back to the Congo after Dodd Frank, and worked to set up responsible sourcing initiatives in the war-torn Eastern Provinces. A wide range of companies, from heavyweights like Motorola and Intel to social enterprises like Fairphone, have taken steps to ensure that they can still source from covered countries without fuelling conflict.

Responsible sourcing after Dodd-Frank Section 1502

In July 2011, Motorola Solutions and AVX launched the Solutions for Hope (SfH) project as a pilot initiative to source conflict-free tantalum from the DRC (Katanga province). Other companies such as Nokia, Hewlett Packard and Intel have subsequently joined the project. SfH created a closed-pipe supply line involving a defined set of suppliers and buyers along the whole supply chain, i.e. pre-assessed mine sites that participate in the iTSCi traceability program, ASM cooperatives, exporters, smelters/processors, component manufacturers and end-users.

In March 2014, SfH moved beyond conflict-free Katanga and started expanding in North Kivu, thus bringing a spark of hope to one of Congo's most war-torn provinces. Expansion into what once was a no-go area evidences that SfH is determined to establish groundbreaking practices and, as AVX deputy general manager put it, to 'set an example for other companies to reach the goal of a conflict-free supply chain without victimizing the innocent'.

In September 2012, the Dutch government, together with industry partners Philips and Tata Steel, took the lead in establishing the Conflict-free Tin Initiative (CFTI) in South Kivu, specifically identifying Kalimi as a pilot tin mine. Most recently, CFTI has expanded its mining operations to Maniema, a province bordering South Kivu, which carries the advantage of being far less prone to conflict.

Besides the closed-pipeline approach, another initiative worth mentioning in this context is the Public-Private Alliance for Responsible Minerals Trade, a multi-sector and multi-stakeholder initiative launched in November 2011 by the US Agency for International Development (USAID) with the purpose of: supporting pilot supply chain systems that allow companies to source from conflict-free mines; aligning chain-of-custody programs and practices; and bolstering in-region civil society and governmental capacity.

Over the past three years, both NGOs and private sector players have tried to set up tracing systems to demonstrate the feasibility of sourcing the 3Ts from Dodd Frank covered countries. Companies that joined sourcing schemes such as Solutions for Hope and CFTI, or that actively participate in forums such as the PPA, have tried to persuade their peers of the need to support conflict-free mines in the Great Lakes region.

Policymakers and key spokespeople of the Congolese government, such as the DRC Ambassador to the US, Dr. Faida Mitifu, have also praised the positive impact of Dodd Frank by saying that even though the law was a bitter pill at first, it has helped in creating a positive environment for investment in the country, as more and more clean minerals are being exported and irresponsible exploitation is decreasing.

Rather than building on the momentum created by Dodd Frank, the EU proposal lowers the due diligence bar from mandatory to voluntary, de facto refusing to back pioneering conflict-free sourcing. As Global Witness campaigner Sophia Pickles put it: "We know that only the most progressive companies heed voluntary measures" but what about all the others?

Tellingly, a research paper published by SOMO in November 2013 and looking at current due diligence efforts undertaken by 186 companies that are listed in Europe and make use of 3TG found that the large majority of these businesses are not addressing the issue of conflict minerals at all, thus demonstrating that, in the absence of clear legal obligations, companies are significantly less likely to engage in a thorough, OECD-compliant due diligence exercise.

The Commission's legislative proposal was supposed to be complementary to the US Dodd Frank Act, with the latter targeting downstream businesses and the former focusing on the upstream portion of the supply chain. However, with one segment of legislation being mandatory and the other failing to carry legal liability, how can the rules of the game be truly harmonized?

- **Beyond mining and conflict: the broader due diligence context at a glance**

Conflict minerals due diligence should not be regarded as a purely practical, operational set of measures occurring in a legal and policy vacuum. This paragraph elaborates on how the EU draft law fits (or does not fit) within the broader business & human rights agenda that the international community has been shaping over the past four years, notably with regards to measures pertaining to the State duty to protect human rights and the corporate responsibility to respect human rights.

The State duty to protect human rights is well established in international law, with the International Bill of Rights setting out obligations that States are bound to respect. States must refrain from interfering with or curtailing the enjoyment of human rights (duty to respect); they must protect individuals and groups against human rights abuses (duty to protect) and they must take positive action to facilitate the enjoyment of basic human rights (duty to fulfill).

The duty to protect human rights against abuses resulting from irresponsible business conduct has been further elaborated upon in the UN Guiding Principles on Business and Human Rights (UNGPs), which were adopted unanimously by the UN Human Rights Council in 2011. Alongside reiterating States' duty to protect, the UNGPs also outline the corporate responsibility to respect human rights, including the responsibility to conduct due diligence, and the need for corporations as well as States to provide access to effective remedies when business conduct results in adverse human rights impacts.

Recognizing that conflict zones present specific challenges, policymakers have the primary duty to ensure that businesses operating in those areas do not get involved with gross human rights abuses. To this end, States should ensure that their current policies, legislation, regulations and enforcement measures are effective in addressing the high risk of contamination between business and harmful dynamics of conflict financing and abuse.

In addition, the former UN Secretary General's Special Representative on the issue of business and human rights, John Ruggie, affirmed that, where minerals or metals mined in conflict situations through forced labor, child labor and similarly abusive practices may be part of a company's value chain, this naturally triggers formal due diligence requirements.

In a letter to the President of the EU Commission - José Manuel Barroso - Ruggie also expressed his concern that the Commission's legislative proposal may view due diligence as 'merely optional'.

A key issue in the mandatory vs. voluntary debacle is due diligence reporting, which, according to Ruggie, must be mandatory in order to prevent the least attentive companies from continuing their irresponsible sourcing business undeterred.

Indeed, mandatory business and human rights reporting (usually in a 'comply or explain' format) is gathering pace. In July 2011 the US eased sanctions on financial services and new investment in Myanmar, while introducing the Reporting Requirements on Responsible Investment. The US government has taken the UNGPs as a benchmark for public reporting to be submitted by American individuals or entities investing an aggregate of at least $500,000 in Myanmar. U.S. companies are also required to pass relevant information to the U.S. State Department regarding any risks or impacts that were identified while conducting due diligence on human rights, labor, and the environment, and steps taken to mitigate them.

What do these recent developments mean for the EU? To what extent are business & human rights and due diligence practices already part of EU laws and policies?

At European level, the UNGPs are reflected in the European Commission's 2011 Communication on Corporate Social Responsibility, where the expectation that all EU enterprises meet the corporate responsibility to respect human rights is articulated. The same document invites EU Member States to develop national plans for the implementation of the UNGPs, thus fostering alignment between EU and global action on business and human rights.

Furthermore, the EU Timber Regulation (EUTR) adopted in 2010 provides a precedent for how the EU could approach mandatory supply chain due diligence, and could have offered some lessons learned for a mandatory scheme applying to 3TG. The EUTR requires companies importing and trading timber products to conduct due diligence on their supply chains and denies access to the EU market to illegally harvested timber.

However, the EUTR presents some shortcomings, and should be better aligned with human rights due diligence requirements as set out in the UNGPs and as elaborated in supply chain instruments pertaining to other commodities – notably the OECD Guidance. More precisely, the EUTR does not require independent auditing or public disclosure of due diligence efforts. Nevertheless, the UNGPs make it clear that those companies whose activities pose risks of severe human rights impacts should report formally on due diligence, and the OECD Guidance further adds that independent audits to check the actual implementation of responsible sourcing strategies are an integral component of successful due diligence. These shortcomings do not affect the proposed Regulation on conflict minerals, where Articles 6 and 7 set out third-party audit obligations and disclosure requirements respectively.

Had it combined the mandatory element from the EUTR experience with a sound understanding of due diligence processes as laid down in the UNGPs and OECD Guidance, the EU executive could have mulled over a more progressive draft law.

- **Due diligence and responsible sourcing: a global challenge**

Due diligence should not be confined to 3TG from Central Africa, but rather should be conducted on the supply chains of natural resources originating from any conflict-affected or high-risk area.

The link between international supply chains and violent conflict, with the trade in minerals, precious stones and other commodities bankrolling militia groups or resulting in human rights violations perpetrated by national armies, is not unique to the Congo or to the Great Lakes region.

In Colombia, both combatants from the Revolutionary Armed Forces of Colombia (FARC) and armed groups that rose from the ashes of paramilitary squads are benefiting from the decade-long surge in gold prices and engaging in mining and trading activities.

In 2012, CIT Pax Colombia and Observatorio Internacional reported that up to 20% of the FARC resources are derived from the illegal exploitation of gold.

Also, the challenge is not unique to 3TG. In the past two decades, diamonds have fueled brutal civil wars in a number of countries across Africa: Angola, the Central African Republic, Côte d'Ivoire, the DRC, the Republic of Congo, Liberia and Sierra Leone.

To give but two examples of cases IPIS has closely examined, in the Central African Republic the Seleka rebel coalition has been exploiting the country's diamonds and funneling profits towards insurgent activities; in Angola, a decade after the end of a diamond-funded civil war, the diamond fields in the Lundas are once again the scene of armed violence, this time perpetrated by the regular army and by private security forces.

Besides diamonds, there are many other precious stones marred by their association with violence and abuses. In Myanmar, a top producer of high-quality rubies and jadeite (the most expensive form of jade) the mining industry has been dominated by the military junta for decades. Members of the national army – an army with an abysmal human rights record – have long ruled gem mines and mining companies with an iron hand, rendering extortion and forced labor standard practice.

In short, suffice it to say that the list of examples conjuring up a toxic mixture of natural resources, armed violence and abuses is quite long and it definitely goes beyond the borders of Dodd Frank covered countries.

Therefore, the fact that the EU did not come up with a list of countries affected by the Regulation is a very positive and encouraging sign.

The broad geographical scope of the draft law is showing that the EU executive fully appreciates the global nature of the due diligence challenge, recognizing that companies may be at risk of contributing to or being associated with conflict financing and significant adverse human rights impacts in any conflict-affected or high-risk area, and not just in the Congo.

However, as far as the material scope is concerned, the draft law does not go beyond 3TG. Ideally, the Regulation should have been wide enough to apply to all natural resources produced in any conflict-affected or high-risk area, but realistically, the OECD Guidance Supplements only provide detailed due diligence advice for responsible supply chain management of 3TG.

Since specific due diligence requirements and processes differ depending on the mineral/ commodity, it is unlikely that, at this stage, the EU could have pushed the boundaries of its Regulation beyond 3TG.

- **Public procurement is a powerful tool**

The EU initiative also proposes a number of incentives to encourage supply chain due diligence by EU companies, notably public procurement incentives for companies selling products such as cell phones, printers and computers containing tin, tantalum, tungsten and gold. Businesses wishing to secure EU contracts should be able to prove that they have invested time and resources into setting up solid supply chain management systems. In addition to buying their electronic equipment exclusively from responsible importers, EU officials have stated that they would push to encourage Member States to do the same.

Whilst the proposed Regulation is seriously flawed in light of its non-mandatory nature, it should be noted that public procurement is a powerful tool and, if appropriately used, it could bring about a positive 'state-business' nexus.

Examples of states and international institutions that have tailored their procurement policies to address conflict-related and human rights issues abound.

In the US, President Clinton banned federal agencies from purchasing goods made with exploitative child labor, and the US Department of Labor regularly updates a list of such goods and identifies the countries where they have been manufactured.

In South Africa, procurement is extensively used as a tool to redress socio-economic inequalities resulting from decades of colonization and apartheid, and to promote fairer labor practices.

In Switzerland, procurement incentives have been used to bridge the gender gap: equal pay for men and women is a *conditio sine qua non* for performing public contracts.

International organizations have also sought to align their procurement policies with the basics of international human rights law. For instance, UNICEF will not contract suppliers that have used child labor, and the ILO has strongly emphasized that its Convention 94 demands clear linkages between fair labor standards and public contracts.

The UNGPs specifically address the role States could play when governments and public authorities engage in commercial transactions. As recognized by experts at the 2013 UN Forum on Business and Human Rights, the purchase of goods and services by public bodies accounts for hundreds of billions of dollars each year and expenditure on public procurement within OECD countries amounts to an average of 13% of GDP. At the European level, it represents 19% of European GDP. The EU could therefore play an important role when it comes to influencing corporate behavior through procurement incentives.

However, it is too early to say whether procurement measures will actually achieve more than just preaching to the converted, since generally companies securing government contracts are the largest players and would, in any case, seek to comply with industry best practices.