IPIS Insights on Due Diligence on Mineral Sourcing

REGULATING RESPONSIBLE SOURCING OF 3TG MINERALS

IPIS

Comparative analysis of Section 1502 of the US Dodd-Frank Act and the EU Conflict Minerals Regulation, lessons learned and risks for implementation

1. EDITORIAL

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Comparative analysis of Section 1502 of the US Dodd-Frank Act and the EU Conflict Minerals Regulation, lessons learned and risks for implementation

Antwerp, 20 December 2019

Front cover image: Cassiterite Mine in Tanganyika, DRC (Photo: IPIS)

Author: IPIS

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Layout: SAKADO (*https://www.sakado.be/*)

References

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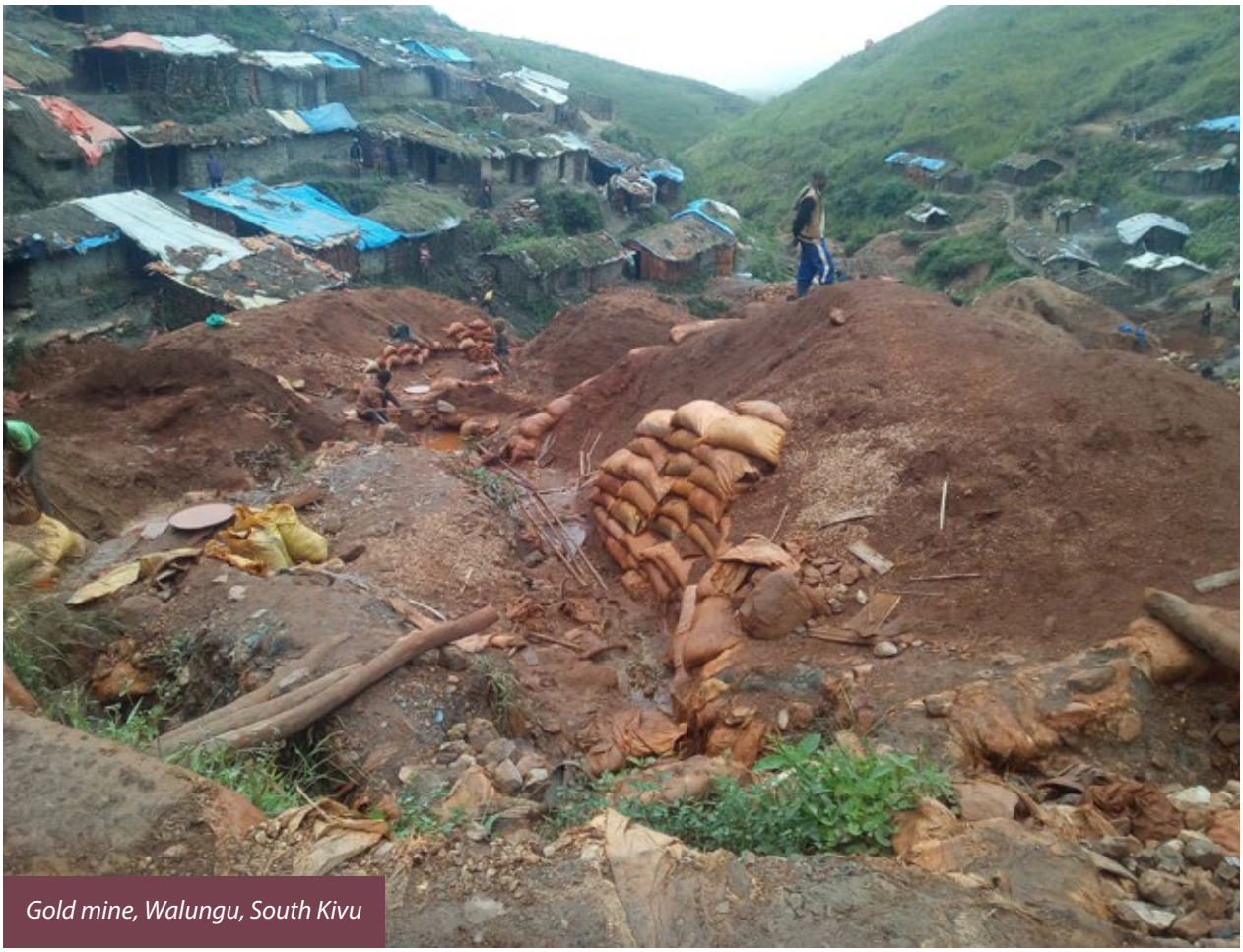


Gold mine, Walungu, South Kivu

INTRODUCTION

This report provides a detailed comparative analysis of Section 1502 of the US Dodd-Frank Act and the EU Conflict Minerals Regulation. After a short introduction of both laws, and the context in which they were drafted, the two legislations are compared on their most important elements such as the legal requirements. While both pieces of legislation aim to help break the link between income generated by the 3TG trade and the perpetuation of armed conflict, they do differ in their requirements, the companies concerned and the geographical scope. For instance, the EU Regulation puts more emphasis on the obligation to have a good supply chain due diligence system in place while the Dodd-Frank 1502 puts the emphasis on adequate reporting.[1]

It is important to be aware of these differences when looking at risk and opportunities for implementation. The impact of the Dodd-Frank 1502 implementation is discussed, including lessons learned, in the third part of this report. These lessons were indeed taken into account when the EU Regulation was drafted. Nevertheless, the EU Regulation will come with its own implementation challenges. These challenges and recommendations are discussed in the final section of this report.

1 Section 1 and 2 of this report are sourced from: Verbruggen, D., Due Diligence and the Kimberley Process, a study commissioned by the Antwerp World Diamond Centre, April 2018, unpublished.

1. INTRODUCTION TO THE DOWNSTREAM REGULATIONS ON SOURCING AND TRADE OF 3TG MINERALS

1.1. GENESIS US DODD-FRANK ACT SECTION 1502

The legislative process in the US started in 2008 and resulted in a provision on conflict minerals from the DRC and adjoining countries in a larger law that became known as the Dodd-Frank Act. The Act is targeted towards Wall Street reform in response to the financial crisis and was signed into law by US President Obama in July 2010.

The provision on conflict minerals is contained in Section 1502 of the Act and imposes legal obligations with regard to due diligence measures by companies that trade on US Exchanges and are implicated in the supply chains of tin, tantalum, tungsten and gold (3TG). Section 1502 was the result of several years of intense lobbying by, among others, advocacy groups and faith-based investors.

The Dodd-Frank Section 1502 created a great sense of urgency in international diplomatic circles and in the business community. The pressure to create conflict-free supply chains of the minerals concerned mounted further when the UN Group of Experts released its November 2010 report, which illustrated in detail how in the DRC both rebels and the national army were profiting from the mineral trade.

DODD-FRANK SECTION 1502

Minerals concerned: Conflict minerals, which are equated to columbite-tantalite (tantalum), cassiterite (tin), wolframite (tungsten), gold or their derivatives; or any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country.

Definition: a product may be labelled as DRC conflict free if the product does not contain conflict minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country.

1.2. GENESIS EU CONFLICT MINERALS REGULATION

After the US Senate passed the Dodd-Frank Act, pressure on the EU to address the issue of DRC conflict minerals mounted. In October 2010 the European Parliament (EP) welcomed the new US 'Conflict Minerals' Law in its Resolution regarding "failures in protection of human rights and justice in the Democratic Republic of Congo". Despite several requests by EP to the European Commission (EC) and the Council to examine a legislative initiative along these lines, the EC initially limited itself to vague statements without concrete action.

The EU in the following years undertook consultations and an impact assessment on a possible Conflict Minerals Legislation.[2] In 2011, the EC announced its intention to explore ways of improving due dili-

2 This paragraph is sourced from: Bulzomi, A., The EU draft law on conflict minerals due diligence: a critical assessment from a business & human rights standpoint, April 2014, IPIS.

gence throughout supply chains. 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.

In March 2014, the EU Trade Commissioner presented a strategy in a Joint Communication and draft regulation by the EU Commission and High Representative for Foreign Affairs and Security Policy on Responsible sourcing of minerals originating in conflict-affected and high-risk areas. Further events led up to a political agreement between the EC, Council of the EU and the EP in November 2016 on the text of the EU Conflict Minerals Regulation ('EU Regulation'). The EU Regulation became law in 2017 and allows for a transition period for companies concerned until January 2021, when it will come in full force.

EU REGULATION

Minerals concerned: Tin, tantalum, tungsten and gold (3TG minerals).

Definition:

Supply chain due diligence: the obligations of Union importers of tin, tantalum and tungsten, their ores, and gold in relation to their management systems, risk management, independent third-party audits and disclosure of information with a view to identifying and addressing actual and potential risks linked to conflict-affected and high-risk areas to prevent or mitigate adverse impacts associated with their sourcing activities.

Conflict-affected and high-risk areas: areas in a state of armed conflict or 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.

2. COMPARISON OF DODD-FRANK SECTION 1502 AND THE EU CONFLICT MINERALS REGULATION

2.1. SENSE OF THE US AND EU LEGISLATORS

Both pieces of legislation aim to help break the link between income generated by the 3TG minerals trade and the perpetuation of armed conflict.

DODD-FRANK SECTION 1502

Sense of the US legislator:

Conflict minerals originating in the DRC help finance conflict and contribute to an emerging humanitarian situation.

EU REGULATION

Sense of the EU legislator:
There are several points in the 3TG minerals and metals supply chain where money from the sale may go to armed groups or criminals. This source of income can help perpetuate armed conflict, violence and human rights abuses, often in weak or unstable countries. Making sure that these armed groups and criminals can no longer rely on the purchase of 3TG minerals as a source of income is a way of making it more difficult for them to continue their activities, and of tackling human rights abuses.

2.2. REQUIREMENTS

Both laws impose obligations with regard to 3TG minerals supply chain due diligence.

Dodd-Frank 1502 is a law solely pertaining to the disclosure of supply chain due diligence information. Concretely, this means first of all that companies should first perform due diligence to determine whether their 3TG minerals are sourced from the DRC or neighbouring countries, and disclose both this determination and the due diligence process leading to it. Secondly, if 3TG minerals do originate from the region, companies have to undertake due diligence on the source (country, mine, processing facilities) and chain of custody of the minerals, describe this in a Conflict Minerals Report, and have their report subjected to a certified private sector audit.

Under Dodd-Frank 1502, it is not prohibited for covered companies to, for instance, source 3TG minerals emanating from rebel-held areas in the DRC or neighbouring countries. Possible penalisation is only contingent on companies' reporting obligations, and these are contingent on the soundness of due diligence practices, i.e. unsatisfactory due diligence leads to insufficiently substantiated claims about the origin and chain of custody of the minerals, and hence to unsound reporting and flawed disclosure. Dodd-Frank 1502 therefore has been termed a name-and-shame bill. The underlying idea is that companies will refrain from sourcing 3TG minerals tainted by conflict in the DRC and the wider region to protect their reputation towards investors and consumers.

Well-resourced industry associations retorted by collaborating with the Responsible Business Conduct Unit of the OECD's Investment Division on supplements to the OECD Guidance for minerals and gold. These supplements introduced the notion of "choke points" in the supply chains of the minerals concerned, i.e. key points of transformation that include relatively few actors that handle or process the material and have higher visibility and control over upstream stages (e.g. production and trade). For 3T minerals these choke points are smelters and for gold refiners. The Electronic Industry Citizenship Coalition (EICC) and the Global e-Sustainability Initiative (GeSI) under their Responsible Minerals Initiative (RMI) created an audit programme for 3TG smelters and refiners (the Responsible Minerals Assurance Process).[3] In the gold sector the London Bullion Market Association (Responsible Gold Guidance[4]), the World Gold Council (Conflict Free Gold Standard[5]), and the Responsible Jewellery Council (Chain-of-Cus-

3 http://www.responsiblemineralsinitiative.org/responsible-minerals-assurance-process/, last accessed on 16 December 2019.
4 http://www.lbma.org.uk/responsible-sourcing, last accessed on 16 December 2019.
5 https://www.gold.org/who-we-are/our-members/responsible-gold/conflict-free-gold-standard, last accessed on 16 December 2019.

tody Certification[6]) developed similar audit programmes for refiners. These audit programmes were designed to, among other things, satisfy companies' requirements under Dodd-Frank 1502.

The EU legislator found this system devised by industry and the OECD already in place, and legislated accordingly. The EU Regulation makes the OECD Guidance recommendations mandatory for importers and smelters or refiners sourcing 3TG minerals from CAHRAs. The EC will draw up a White List of "responsible smelters/refiners". Importers that demonstrate, a.o. through third party audits, that they source exclusively from smelters and refiners on the White List, will not have to carry out audits on their suppliers. Otherwise, importers have to conduct due diligence, confirmed by third-party audits, to demonstrate they source from smelters and refiners with correct due diligence practices. When importers find smelters' and refiners' practices to be insufficient or associated with risks, they will have to manage and report on this.

The EU Regulation thus puts more emphasis on the obligation to have a good supply chain due diligence system in place than on adequate reporting. By making the OECD Guidance mandatory, the EU implicitly prohibits importers to contribute to conflict-financing, serious human rights abuses and supporting non-state armed groups, as the OECD Guidance in its Annex II requires companies to disengage from suppliers who are involved in these types of activities. The law however, like Dodd-Frank 1502, is more concerned with due diligence systems and their implementation, than with the substance of the matter: responsible sourcing. Compliance or non-compliance will be verified against the model for due diligence set out in the OECD Guidance, which does not contain performance indicators for due diligence practices, as it is not an audit standard. Much work still needs to be done by the EC, which will issue a handbook of non-binding guidelines for Member State Competent Authorities with steps to conduct ex-post checks on companies under their jurisdiction.

Cassiterite mine, Mwenga, South Kivu

6 https://www.responsiblejewellery.com/chain-of-custody-certification/, last accessed on 16 December 2019.

DODD-FRANK SECTION 1502

Requirements:

1. Companies trading on US stock exchanges and using 3TG minerals must disclose annually whether the minerals originate from the DRC or an adjoining country. The final rule requires a company to provide the disclosure on a new form (Form SD) to be filed with the Securities and Exchange Commission (SEC).

2. In cases in which 3TG minerals do originate from the DRC or a neighbouring country, the company must submit to the Commission a report that includes:

   a) a description of the measures taken by the company to exercise due diligence on the source and chain of custody of such minerals, which measures shall include an independent, certified private sector audit of the report. This audit is conducted in accordance with standards established by the Comptroller General of the United States, in accordance with rules promulgated by the Commission, in consultation with the Secretary of State.

   b) a description of the products manufactured or contracted to be manufactured that are not DRC conflict free;

   c) the facilities used to process the conflict minerals, the country of origin of the conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity.

The SEC Final Rule offers further specifications of point 2):

- If the inquiry determines both of the following to be true: the company *knows or has reason to believe* that the minerals *may have* originated in the covered countries; the company *knows or has reason to believe* that the minerals *may not be* from scrap or recycled sources, then the company must undertake "due diligence" on the source and chain of custody of its conflict minerals and file a Conflict Minerals Report as an exhibit to the Form SD.

- If a company determines that its products are "DRC conflict free" — that is the minerals may originate from the covered countries but did not finance or benefit armed groups — then the company must undertake the following audit and certification requirements: obtain an independent private sector audit of its Conflict Minerals Report; certify that it obtained such an audit; include the audit report as part of the Conflict Minerals Report; identify the auditor.

If a company's products have not been found to be "DRC conflict free," then the company in addition to the audit and certification requirements must describe the following in its Conflict Minerals Report: the products manufactured or contracted to be manufactured that have not been found to be "DRC conflict free"; the facilities used to process the conflict minerals in those products; the country of origin of the conflict minerals in those products; the efforts to determine the mine or location of origin with the greatest possible specificity.

EU REGULATION

Requirements:

The EU Regulation establishes a Union system for supply chain due diligence by Union importers, and of smelters and refiners sourcing 3TG minerals from conflict-affected and high-risk areas, and lays down their supply chain due diligence obligations. These obligations are drawn from the OECD Due Diligence Guidance, which specifies company measures regarding: a management system; risk management; third-party audits; disclosure.

Union importers of metals shall be exempted from the obligation to carry out third-party audits provided they make available substantive evidence, including third-party audit reports, demonstrating that all smelters and refiners in their supply chain comply with the EU Regulation. The requirement of substantive evidence shall be deemed to be fulfilled where Union importers of metals demonstrate that they are sourcing exclusively from smelters and refiners listed by the Commission.

The so-called White List of smelters and refiners shall be drawn up taking into account global responsible smelters and refiners covered by supply chain due diligence schemes recognised by the Commission. Due diligence schemes are essentially industry-led responsible sourcing initiatives that companies can apply to join. They are envisaged by the Commission as a tool that may facilitate the fulfilment by economic operators of the requirements of parts of the EU Regulation. A delegated Regulation (EU) 2019/429 of 11 January 2019 supplements the main EU Regulation by establishing the methodology and criteria that the Commission will use to assess whether due diligence schemes can be recognised as 'facilitating' a company's compliance with the EU Regulation.

The Commission is clear, however, that Union importers retain individual responsibility to comply with the due diligence obligations set out in the EU Regulation, and that being covered by or a member of a due diligence scheme does not automatically mean that a company is undertaking due diligence to the required standard. Downstream companies must therefore continue to independently verify and report on the due diligence of their suppliers and, critically, raise questions where reporting is insufficient or where it flags a supply chain risk.

The Commission shall establish and keep up-to-date a register of recognised supply chain due diligence schemes. That register shall be made publicly available on the internet.

2.3. COMPANIES CONCERNED

Dodd-Frank 1502 and the EU Regulation differ widely on this point. Dodd-Frank 1502 concerns companies trading on US stock exchanges that use 3TG minerals in products they (contract to) manufacture. Consequently, the law targets many major corporations and brands, mainly in the electronics and communications, aerospace, automotive and jewellery industries. Since filings to the SEC initiated in 2014, approximately 1,300 companies filed conflict minerals disclosures each year, including corporate giants

such as Apple and Microsoft, and in the jewellery retail sector Tiffany & co. and Signet, with a great interest to protect their brand image vis-à-vis shareholders and consumers.[7]

The EU Regulation exempts companies using 3TG minerals in manufactured products. The EU's own estimate is that the Regulation applies directly to between 600 and 1,000 EU importers, and indirectly to about 500 smelters and refiners of 3TG minerals, whether they are based inside the EU or not.[8] It is worth mentioning that raw materials are rather trivial in EU trade flows with non-EU countries. The total import of raw minerals represented less than 5% of EU imports in 2018, whereas machinery, vehicles and other manufactured goods represented 56% of EU imports.[9] In short, the vast majority of EU companies and consumers do use the 3TG minerals, but they are importing them beyond the metal stage and, therefore, fall outside the EU Regulation.

Moreover, unlike the US, the EU proposed exemptions for smaller importers, making the regulation voluntary for small and medium enterprises, while it remains mandatory for the larger importers.

DODD-FRANK SECTION 1502

Companies concerned:

Companies listed on US stock exchanges for which conflict minerals are necessary to the functionality or production of a product manufactured by the company.

The SEC Final Rule adds that the law equally applies to companies contracting to manufacture a product. A company is considered to be "contracting to manufacture" a product if it has some actual influence over the manufacturing of that product. This determination is based on facts and circumstances, taking into account the degree of influence a company exercises over the product's manufacturing.

EU REGULATION

Companies concerned:

EU importers, and smelters and refiners of tin, tantalum and tungsten, their ores, and gold. The EU Regulation does not apply to Union importers of minerals or metals where their annual import volume is below the volume thresholds set out in Annex I. All volume thresholds are set at a level that ensures that no less than 95%, of the total volumes imported into the Union of each mineral and metal is covered.

7 US Government Accountability Office, SEC Conflict Minerals Rule: 2017 Review of Company Disclosures in Response to the U.S. Securities and Exchange Commission Rule, April 2017, Washington, p. 2.

8 http://ec.europa.eu/trade/policy/in-focus/conflict-minerals-regulation/regulation-explained/, last accessed on 16 December 2019.

9 Eurostat. (2019, March). Extra-EU trade in goods, Figure 7. Available at: https://ec.europa.eu/eurostat/statistics-explained/index.php/Extra-EU_trade_in_goods

2.4. GEOGRAPHIC SCOPE

Also on this point the Dodd-Frank 1502 and the EU Regulation differ widely. Dodd-Frank 1502 is specifically targeted towards 3TG minerals from the DRC and neighbouring countries. While the EU Regulation introduces the notion of conflict-affected and high-risk areas (CAHRAs), taken from the OECD Guidance.

The OECD Guidance defines CAHRAs in the following terms: "Conflict-affected and high-risk areas are identified by the presence of armed conflict, widespread violence or other risks of harm to people. Armed conflict may take a variety of forms, such as a conflict of international or non-international character, which may involve two or more states, or may consist of wars of liberation, or insurgencies, civil wars, etc. *High-risk areas* may include areas of political instability or repression, institutional weakness, insecurity, collapse of civil infrastructure and widespread violence. Such areas are often characterized by widespread human rights abuses and violations of national or international law."[10]

The EC wrote a draft handbook with non-binding guidelines to assist operators carrying out supply chain due diligence with the identification of conflict-affected and high-risk areas.[11] The EC has also contracted external experts to provide a list of conflict-affected and high-risk areas, which it would regularly update. The list will be indicative and non-exhaustive. Companies will still have to comply with the regulation when operating in conflict-affected areas that are not listed.

DODD-FRANK SECTION 1502

Geographic scope:

The DRC and adjoining countries, meaning countries that share an internationally recognized border with the DRC (i.e. Rwanda, Burundi, Tanzania, Uganda, South Sudan, Central African Republic, Republic of the Congo, Angola, Zambia).

EU REGULATION

Geographic scope:

Conflict-affected or high-risk areas.

The Commission has called upon external expertise that will provide an indicative, non-exhaustive, regularly updated list of conflict-affected and high-risk areas.

EU importers sourcing from areas which are not mentioned on that list shall also maintain their responsibility to comply with the due diligence obligations under the EU Regulation.

10 OECD, Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: Third Edition, OECD Publishing, Paris, p. 66.

11 Official Journal of the European Union, Commission Recommendation (EU) 2018/1149 of 10 August 2018 on non-binding guidelines for the identification of conflict-affected and high-risk areas and other supply chain risks under Regulation (EU) 2017/821 of the European Parliament and of the Council. (*https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018H1149&from=EN*)

2.5. THEMATIC SCOPE

While the thrust of both laws is clear, neither the US nor the EU legislator has been very thoughtful in articulating the thematic scope of respective laws. Dodd-Frank 1502 mentions financing of armed groups, labour or human rights violations. Scattered over several articles, the EU Regulation mentions conflict financing by armed groups and security forces, human rights abuses, child labour, sexual violence, etc. By incorporating the OECD Guidance including Annex II in the law, however, the EU Regulation implicitly covers the same issues as the OECD Guidance.

DODD-FRANK SECTION 1502

Thematic scope:

Financing of armed groups, labour or human rights violations. The term "armed group" means an armed group that is identified as perpetrator of serious human rights abuses in the annual Country Reports on Human Rights Practices relating to the DRC or an adjoining country.

EU REGULATION

Thematic scope:

Conflict financing (armed groups and security forces). Human rights abuses that may include child labour, sexual violence, the disappearance of people, forced resettlement and the destruction of ritually or culturally significant sites.

2.6. TRANSPARENCY

Public disclosure is paramount in Dodd-Frank 1502. Due diligence information must be filed with the SEC and must be publically available on companies' websites. This is explained by the fact that the law, which is embedded in a Wall Street Reform Act, is meant to inform and protect investors, which through conflict minerals disclosure requirements are enabled to assess social and reputational risks. Some investors with a lot of leverage, such as ethical pension funds, have a significant interest in compliance by companies with Dodd-Frank 1502.

EU importers are required to publicly report on their due diligence practices, including on the internet, in conformance with relevant requirements under the OECD Guidance.

DODD-FRANK SECTION 1502

Transparency:

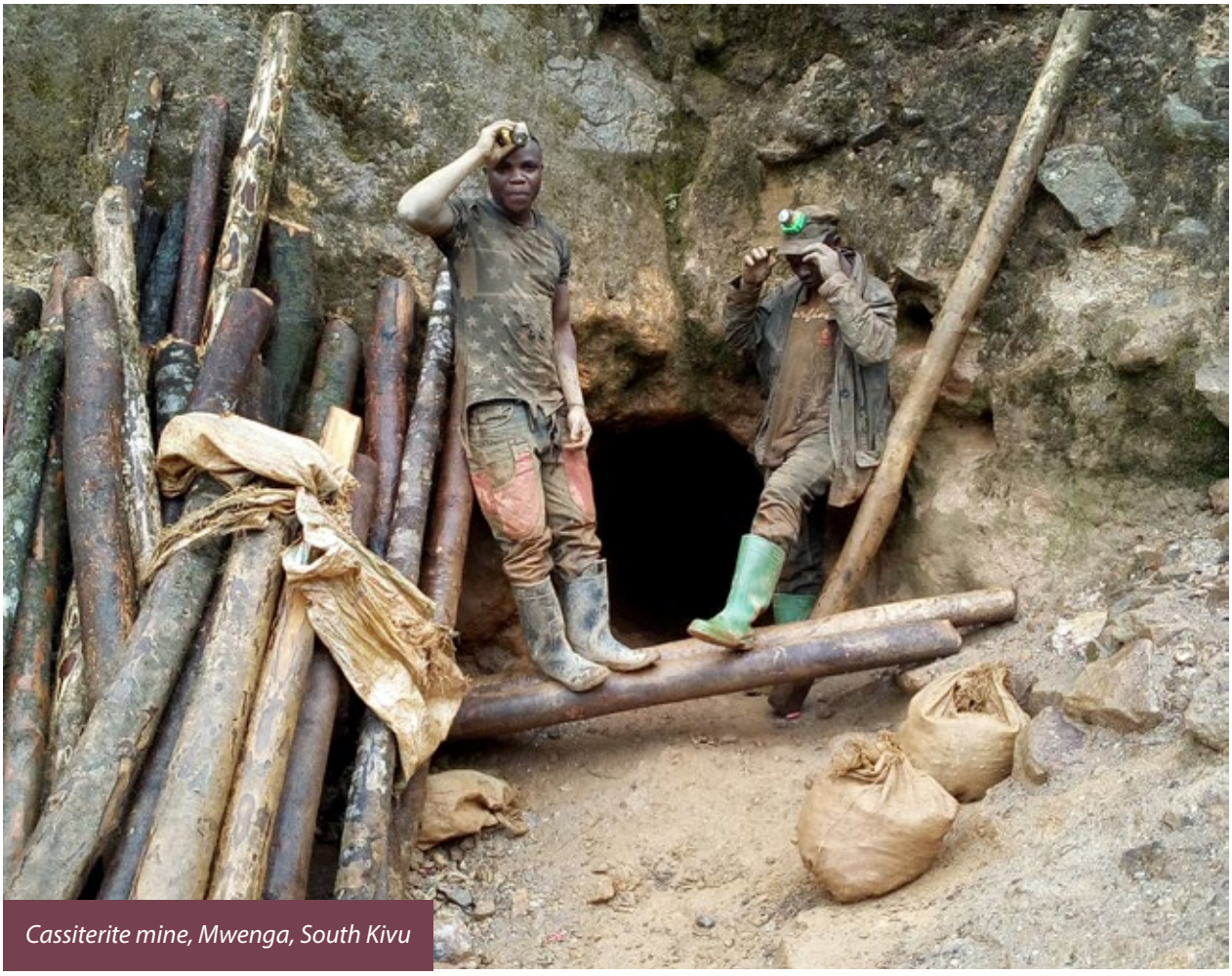
Companies' determination of the source of conflict minerals (not) being in the DRC or adjoining countries and due diligence reports are to be filed with the SEC. The SEC Final Rule specifies that the determination and due diligence reports should be published on companies' websites.

EU REGULATION

Transparency:

- Third-party audits or evidence of conformity with a due diligence scheme recognised by the EC are to be made available to EU Member States' Competent Authorities.
- Importers concerned make available to their immediate downstream purchasers all information gained and maintained pursuant to their supply chain due diligence.
- Importers shall, on an annual basis, publicly report as widely as possible, including on the internet, on their supply chain due diligence policies and practices for responsible sourcing. That report shall contain the steps taken by them to implement the obligations as regards their management system, and their risk management, as well as a summary report of the third-party audits, including the name of the auditor, with due regard for business confidentiality and other competitive concerns.

When importers can reasonably conclude that metals are derived from scrap or recycled sources, they should publicly disclose their conclusion and describe in reasonable detail the supply chain due diligence measures exercised in reaching it.

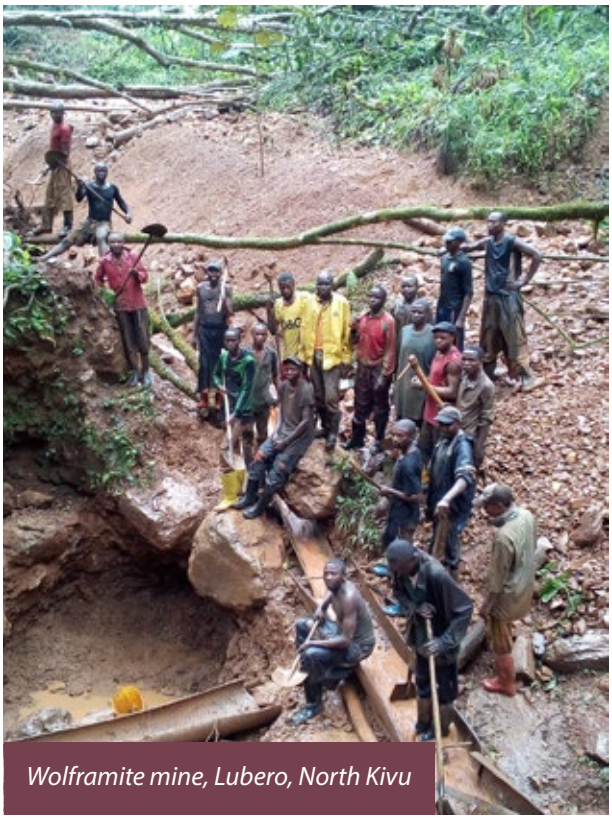


Cassiterite mine, Mwenga, South Kivu

2.7. FLANKING MEASURES AND OVERSIGHT

Both the US government and the EU have committed themselves to provide documents to assist companies with their legal requirements. Both laws also ensure a periodical review of the effectiveness of the law. In the case of the EU Regulation, the three-yearly reviews could play an important role in establishing a more ambitious Regulation.

Both legislations do not include any legal penalties for non-compliance with the law. Dodd-Frank 1502 entails the risk of brand damage following public naming and shaming. For the EU Regulation, Member States set the rules that apply to infringements. In case of non-compliance, the Competent Authorities issue a notice of remedial action to be undertaken by the company (see also section 3.2.4).



Wolframite mine, Lubero, North Kivu

DODD-FRANK SECTION 1502

Flanking measures and oversight by government:

- The Secretary of State is to submit a strategy to address the linkages between human rights abuses, armed groups, mining of conflict minerals, including:
  - A plan to provide guidance to commercial entities seeking to exercise due diligence on and formalize the origin and chain of custody of conflict minerals.
  - A description of punitive measures that could be taken against individuals or entities whose commercial activities are supporting armed groups and human rights violations in the DRC.
- The Secretary of State is to produce a map of mineral-rich zones, trade routes, and areas under the control of armed groups in the DRC and adjoining countries.
- The Comptroller General of the US is to submit bi-annual reports as to the effectiveness of Section 1502.
- The Secretary of Commerce is to submit an annual report on private sector auditing of the Conflict Minerals Reports, including: standards of best practices; a listing of all known conflict mineral processing facilities worldwide.

EU REGULATION

Flanking measures and oversight by the EU and Member States:

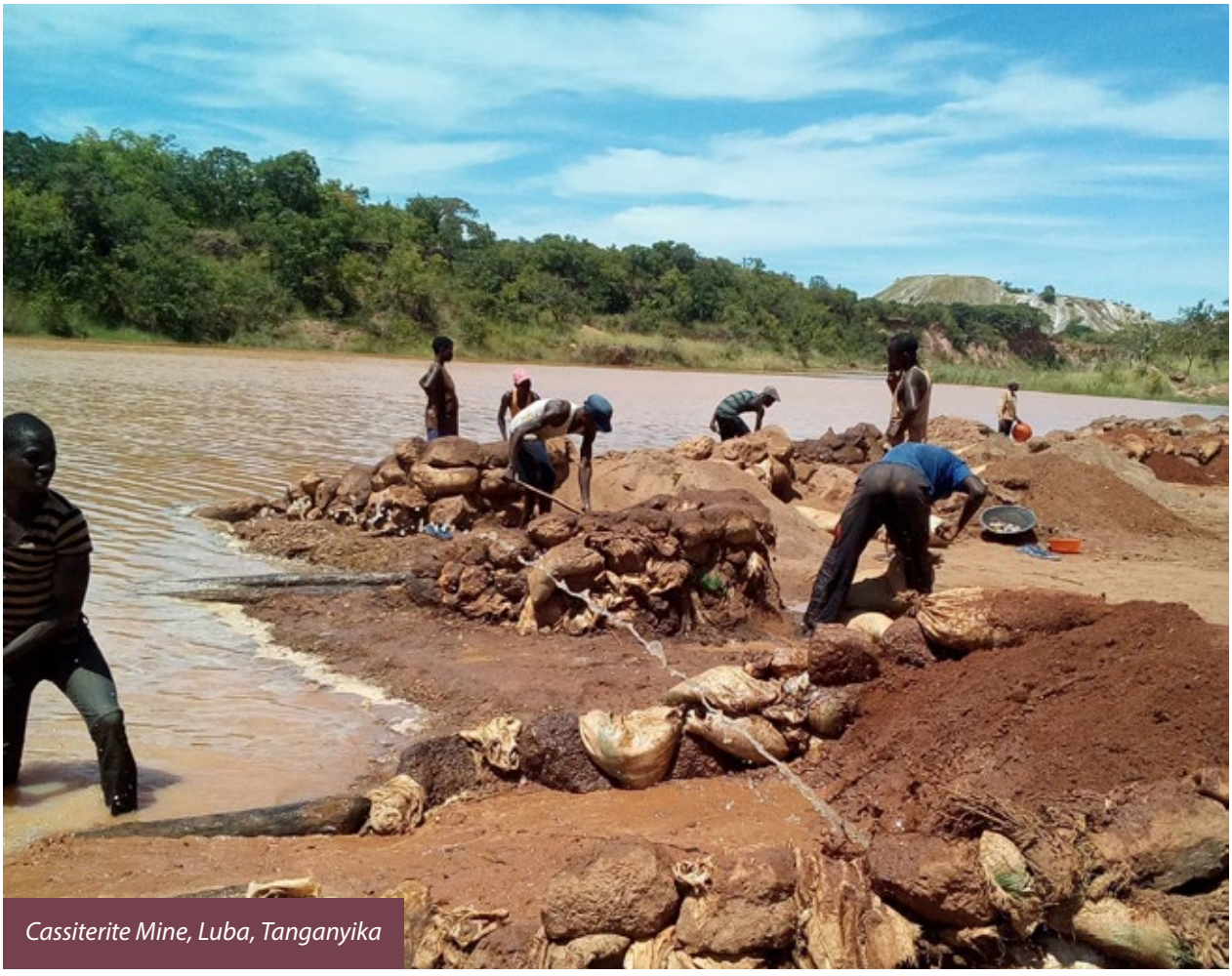
- ***EU Commission:***
  - By 1 January 2023 and every three years thereafter, the Commission should review the functioning and the effectiveness of the Union system, and its impact on the ground.
  - The EC should review the cost of responsible sourcing and of third-party auditing, the administrative consequences of such sourcing and auditing and their potential impact on competitiveness, in particular that of small and medium-sized enterprises (SMEs). The EC should ensure that micro, small and medium-sized enterprises benefit from adequate technical assistance and should facilitate the exchange of information in order to implement the Regulation.[12]
  - The review shall include an independent assessment of the proportion of total downstream Union economic operators with tin, tantalum, tungsten or gold in their supply chain, which have due diligence schemes in place. The review shall assess the adequacy and implementation of these due diligence schemes and the impact of the Union system on the ground as well as the need for additional mandatory measures in order to ensure sufficient leverage of the total Union market on the responsible global supply chain of minerals.
  - The EC has implementing powers relating to the recognition of due diligence schemes as equivalent, the withdrawal of equivalence in the case of deficiencies, as well as the establishment of the list of global responsible smelters and refiners.
  - The EC has published a handbook with non-binding guidelines in the form for economic operators, explaining how best to apply the criteria for the identification of conflict-affected and high-risk areas.[13]
  - In order to ensure clarity of tasks and consistency of action among Member State competent authorities, the Commission shall prepare non-binding guidelines in the form of a handbook detailing the steps to be followed by Member State competent authorities carrying out the *ex-post* checks.

12 EC, Support for SMEs through new initiative on minerals and metals' supply chain due diligence, 1 July 2019. *https://ec.europa.eu/growth/content/support-smes-through-new-initiative-minerals-and-metals-supply-chain-due-diligence_en*, last accessed on 16 December 2019.

13 Official Journal of the European Union, Commission Recommendation (EU) 2018/1149 of 10 August 2018 on non-binding guidelines for the identification of conflict-affected and high-risk areas and other supply chain risks under Regulation (EU) 2017/821 of the European Parliament and of the Council. (*https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018H1149&from=EN*)

EU REGULATION

- ***Member States:***
  - Each Member State shall designate one or more Competent Authorities responsible for the application of the EU Regulation. Member State Competent Authorities should be responsible for ensuring the uniform compliance of Union importers of minerals or metals who fall within the scope of the EU Regulation by carrying out appropriate *ex-post* checks. Records of such checks should be kept for at least five years. Member States should be required to establish the rules applicable to infringements of the EU Regulation. Based on the findings of the review, the EC shall assess whether Member State Competent Authorities should have competence to impose penalties upon Union importers in the event of persistent failure to comply with the obligations set out in the EU Regulation. It may, as appropriate, submit a legislative proposal to the EP and to the Council in this regard.
  - By 30 June each year, Member States shall submit to the EC a report on the implementation of the EU Regulation and, in particular, on notices of remedial action issued by their Competent Authorities and on the third-party audit reports made available.



Cassiterite Mine, Luba, Tanganyika

3. IMPLEMENTATION

3.1. IMPACT OF THE IMPLEMENTATION OF THE DODD-FRANK SECTION 1502

Even though many actors make sharp statements about the impact of Dodd-Frank 1502 (both negative and positive), it should be noted that when Dodd-Frank 1502 came into effect a wide range of other responsible sourcing and/ or formalisation initiatives were simultaneously being implemented. The different initiatives' effects overlap, sometimes supporting and sometimes contradicting one another. As such, none of the initiatives' impacts can be assessed in complete isolation.

In any case Dodd-Frank 1502 did create momentum to increase efforts to address conflict financing from mineral exploitation and trade, and efforts to increase the volume of responsible mineral trade. The development and implementation of several other initiatives (including certification mechanisms, traceability programs, and validation of mining sites) have been accelerated as a consequence of Dodd-Frank 1502.

Increased scrutiny on conflict financing from mineral trade in the DRC has led to socio-economic consequences as most international mineral traders abstained from sourcing minerals from the DRC in 2010. This was the so-called *de facto* embargo.[14] Hundreds of thousands of people have been working in eastern DRC's mines, providing an important source of income for the households' livelihoods. Consequently, an estimated 2 million people have indirectly experienced these difficult socio-economic consequences, including decreasing revenues (for miners as well as other people in local communities), increasing number of thefts, decline of local/retail trade, rising number of school drop-outs, etc. In many areas, miners have responded to this decline by turning to the informal gold mining sector because this sector was not affected by the *de facto* embargo.

IPIS research in the DRC[15] reveals that the trade in ASM 3T minerals has revived to a certain extent. The socio-economic situation has gradually improved and insecurity has decreased in less isolated mining areas that are closely watched by the international community and local stakeholders. More remote areas, on the other hand, which have not yet profited from more concrete initiatives to resuscitate trade, have not witnessed an improvement of the socio-economic or security situation. This is especially true for the ASM gold sector. The gold sector employs 80% of the artisanal miners in eastern DRC nowadays.

The majority of responsible sourcing programs in the DRC are focussing on 3T minerals. There are a few pilot traceability projects for ASM gold. Compared, however, to the 3T mineral sector, these initiatives are very localised and hence their impact is limited in scope. A high level of informality characterizes the ASM gold sector in DRC. The militarisation of, and interference with ASM gold sites and trading points remain key challenges.

14 Zaragoza Montejano, A., Matthysen. Conflict Minerals Initiatives in DR Congo: Perceptions of local communities. IPIS, November 2013. Among other things, the report discusses the socio-economic consequences of the suspension of artisanal mining in 2010, instigated by the DRC president, and a subsequent de facto embargo, as most international mineral traders abstained from returning to the DRC in reaction to Section 1502 of the Dodd-Frank Act.

15 With its database of 2700 ASM mines, IPIS has researched the impact of due diligence programmes. As IPIS has been gathering systematic data on the issue from before 2010, when the first cautious initiatives on responsible sourcing of minerals were launched, it can assess the evolution over the years (Matthysen, Mapping artisanal mining areas and mineral supply chains in eastern DRC, April 2019). Between the year 2016 and 2018, IPIS visited a total of 623 mine sites. Half of these mines were covered by due diligence programmes (Due diligence program includes ITSCI, Just Gold, Kampene BGR and CBRMT) and a majority (52%) of them produced 3T minerals, while the rest were mainly producing gold. During field visits, IPIS surveyors collected information on the conditions of extraction as well as phone numbers from a panel of 8,735 artisanal miners and community members in 19 pre-defined mining zones (Jaillon, Assessing the impact of due diligence programmes in Eastern DRC: A baseline study, April 2019).

In 2017, US President Trump threatened to suspend Dodd-Frank Section 1502.[16] In the same year the SEC decided to suspend enforcement of the costliest requirements of the law.[17] Companies are not required to conduct a due diligence review or an audit, but they still need to file required forms with the SEC and conduct origin inquiries.[18]

According to the Responsible Sourcing Network (RSN), this has encouraged companies to neglect 3TG supply chain due diligence. RSN publishes yearly reports that analyse US companies' supply chain due diligence efforts regarding 3TG minerals from Central Africa. In this year's report, *Mining the Disclosures 2019*, RSN states that *"Six years after the beginning of reporting for Section 1502, little progress can be seen on the understanding of the five-step due diligence framework, and the burden to improve conditions in the Congo falls on a few leading companies."*[19]

Notwithstanding the above, it is important to reiterate that the development and implementation of responsible sourcing programs, especially in the 3T sector, have been incentivised by downstream regulation (e.g. Dodd-Frank 1502). The Dodd-Frank 1502 was never designed as a stand-alone solution but rather intended to serve as a catalyst for and complement to in-region sourcing and certification programs, and industry-driven due diligence initiatives. However, at the time Dodd-Frank 1502 became operational, the upstream due diligence infrastructure was too weak to complement the legislation.[20] Although this has improved over the years for the 3T sector, as described above, there are very little improvements in the upstream due diligence infrastructure for the gold sector.

3.2. ENSURING PROPER IMPLEMENTATION OF THE EU REGULATION

When the EU Regulation was drafted, the perceived negative consequences of the Dodd-Frank Act, namely the above described *de facto* embargo, figured prominently in the debate. Koch and Burlyuk argue that the EU Regulation is seemingly designed so as to avoid or at least minimize the risk of a *de facto* boycott. Firstly, the global geographic scope of the EU Regulation reduces the likelihood of blacklisting one country or region. Secondly, the four years period between the approval and the entry into force of the EU Regulation provides ample time for exporting countries, importing countries and companies to strengthen their policies and prepare for implementation. Thirdly, the EU Regulation has a more inclusive focus: the risk-based approach does not ask European companies to claim that their products are 'conflict free', but they need to show that they have a due diligence system in place, so as to avoid that companies will disengage from challenging environments. Finally, the EU created a special fund for accompanying measures for the 2016–2020 period to promote responsibly sourced minerals from conflict-affected and high-risk areas.[21]

Indeed, these adaptations compared to the Dodd-Frank 1502 will reduce the risks of stigmatization and a *de facto* embargo. However, this is if implemented successfully. Moreover, the implementation of the EU Regulation comes with other risks. The following section gives an assessment of the state of

16 The Guardian, Proposed Trump executive order would allow US firms to sell 'conflict minerals'. 8 February 2017.
17 US SEC, Updated Statement on the Effect of the Court of Appeals Decision on the Conflict Minerals Rule, 7 April 2017.
18 Reuters, SEC halts some enforcement of conflict minerals rule amid review, 7 April 2017.
19 Responsible Sourcing Network, Mining the Disclosures 2019. September 2019.
20 Brackett, A., Levin, E., Melin, Y. (2015), *Revisiting the Conflict Minerals Rule*, Global Trade and Customs Journal, Volume 10, Issue 2.
21 Koch, Dirk Jan & Olga Burlyuk (2019) Bounded policy learning? EU efforts to anticipate unintended consequences in conflict minerals legislation, Journal of European Public Policy.

implementation of the EU Regulation to date, an overview of possible risks to the implementation once into force and addresses recommendations to the EC as well as Member States to fulfil their obligations. The last three paragraphs of this section are a summary of the analysis and recommendations of a joint policy note published earlier this year by a group of NGOs.[22]

3.2.1. Accompanying measures to promote responsibly sourced minerals from CAHRAs

The EU has committed to a series of accompanying measures specifically intended to support responsible mineral sourcing in conflict-affected and high-risk areas.[23] Its efforts are focussed on three main groups of stakeholders, namely the ASM sector, local communities and local authorities. The priority area for support will be the sustainable development of the ASM sector leading progressively to its formalisation because, according to the EC, "*informality of the artisanal and small scale mining remains a major obstacle for setting up a credible due- diligence system*".[24]

Upstream due diligence costs, especially traceability and certification schemes, are typically borne by upstream suppliers instead of the downstream users. Companies and economic actors on the upstream end of the supply chain often transfer these costs on to artisanal miners. The costs of responsible sourcing can act as a negative incentive for ASM producers to participate. Support to the ASM sector is hence rightly a priority of the accompanying measures. This support should avoid disadvantaging the ASM sector, and affecting local livelihoods, because LSM stakeholders will have better capacities to adapt to the new requirements. Without support, ASM miners might increasingly depend on a reduced number of purchasers (e.g. from China), which can negatively impact their trading position in the market.[25] Moreover, accompanying measures should invest in alternative schemes and solutions for certification and traceability that can better distribute its costs along the supply chain.

Although the four years period between the approval and the entry into force of the EU Regulation gives producing countries in theory sufficient time to prepare for implementation, little has been done in this regard so far. To date, there is little knowledge and understanding, nor urge to increase understanding, on the EU Regulation in producing countries. In order to avoid that producing countries are taken by surprise once the regulation will be implemented in 2021, it is crucial to increase the understanding of the EU Regulation among different stakeholders.

IPIS observed in the DRC that people working in the ASM sector have a limited knowledge of, and often misconceptions on, the OECD due diligence criteria. With an eye to both sustainable monitoring and genuine adherence to responsible sourcing, it is at this level that the capacities and awareness on due diligence criteria are most needed. Sensitization at local level is hence vital and should include an explanation of the OECD Guidance and the EU Regulation itself and clarifications on why this Regulation is important. It should clarify the consequences as well as the additional requirements at the upstream level.

22 Joint Policy Note, Ensuring the proper implementation of the EU Regulation on the responsible sourcing of minerals from conflict-affected and high-risk areas, 25 April 2019. https://www.eurac-network.org/sites/default/files/kcfinder/files/Advocacy%20-%20reports%2C%20GTT%20work%20etc/GTT%20RN/Policy%20Note_Implementation_FINAL25%20i.pdf

23 The EU has adopted other accompanying measures aimed at addressing broader and systemic problems throughout mineral supply chains, see: http://publications.europa.eu/resource/cellar/38d9dbaf-a55d-11e3-8438-01aa75ed71a1.0001.04/DOC_1

24 EC, Action Document "Promoting responsible supply chain in the area of conflict minerals (3TG)", 2017. CRIS No.: DCI-HUM/2017/038 793

25 EurAc, The EU Regulation on responsible mineral supply and its accompanying measures: views from civil society from producing countries. Workshop report. December 2019.

The accompanying measures should be used to give the necessary technical and financial support to the ASM sector and (local) governments in producing countries to prepare for the EU Regulation and its requirements. That said, even when implemented with great success, the accompanying measures are not on its own sufficient to guarantee the utilization of responsible sourced minerals from CAHRAs or, in other words, to avoid a *de facto* 3TG embargo from CAHRAs. The availability of responsibly sourced minerals from CAHRAs on the market is still a huge challenge, especially for ASM gold. Creating certification or traceability programs is very costly and complex and in some cases, again especially in the ASM gold sector, nearly impossible. To tackle the issue of disengagement, the accompanying measures need to be reinforced by other interventions, such as (economic) incentives to operators.[26]

3.2.2. Due diligence schemes and their role in facilitating adequate due diligence by their members[27]

To ensure that membership of due diligence schemes (section 2.2) does not offer leeway for poor or absent supply chain due diligence checks in practice, the EC should evaluate whether the scheme is actually undertaking what is laid out in its policies and standards when assessing applications – or make clear on the EC's due diligence scheme recognition page that, although the schemes' standards meet the OECD recommendations *on paper*, there is no guarantee that member companies do so *in practice*.

Future legislators, and companies using the list of recognised due diligence schemes to assist with their supply chain scrutiny, must be mindful of the weakness that there is no (re)verification of schemes that have already been recognised by the EC, nor to changes to the schemes over time.

Finally, given that membership of an industry scheme provides no guarantee of a company's individual responsible sourcing efforts, the legislative mechanisms provide possible loopholes for companies that are not trading to the required standard, but are a member of a scheme. This underlines the importance of individual scrutiny by downstream companies and investors, in particular of the due diligence of any company on the White List that has been placed there by virtue of membership of an industry scheme.

3.2.3. Disclosure of data on national importers[28]

Member State Competent Authorities must ensure that a list of all Union importers that fall under the EU Regulation within their respective country is publicly available. It is important that the public is informed of the Union importers who are subject to due diligence requirements. However, Member States' Customs Agencies have raised objections about their ability to disclose lists of national importers, as well as data regarding their imports. To date, Customs Authorities have cited a 'confidentiality' clause in the Union Customs Code (UCC) as the reason why they will not disclose the names of Union importers.

For the dutiful implementation of the EU Regulation, it is however essential that the list of national importers is made publicly available by Competent Authorities.

26 See: Brackett, A., Levin, E., Melin, Y. (2015), *Revisiting the Conflict Minerals Rule*, Global Trade and Customs Journal, Volume 10, Issue 2.

27 This is a summary of the Joint Policy Note, Ensuring the proper implementation of the EU Regulation on the responsible sourcing of minerals from conflict-affected and high-risk areas, 25 April 2019.

28 This is a summary of the Joint Policy Note, Ensuring the proper implementation of the EU Regulation on the responsible sourcing of minerals from conflict-affected and high-risk areas, 25 April 2019.

Transparency is a cornerstone of supply chain due diligence. The existence of a public list of Union importers allows third parties to raise 'substantiated concerns' over importers' effective compliance with the Regulation, which in turn may trigger ex-post checks by the Competent Authorities. Transparent monitoring of the implementation of the Regulation is necessary for its credibility and effectiveness.

3.2.4. Penalties for non-compliance[29]

The EU Regulation is implemented through public enforcement. Member States are tasked with the effective and uniform implementation of the EU Regulation. Yet, their means of enforcement appear to be limited. While the EU Regulation bestows a solid set of competences on Member States to assess the compliance of Union importers, the only formal instrument provided to tackle non-compliance is a notice of remedial action to be taken by a Union importer. Penalties for non-compliance in contrast are currently not included, so that Competent Authorities would have to use lengthy court processes in cases in which importers ignore a notice of remedial action. This sets an extremely low bar for accountability for companies engaged in irresponsible sourcing or that fail to adequately report on their supply chain efforts.

For the efficient functioning of the EU Regulation, immediate measures for Member States' authorities to react to compliance failures must be available. The objective of the EU Regulation – namely preventing the financing of human rights abuses and conflict, among others, by creating transparency and certainty regarding supply practices – can only be achieved if a critical number of importers indeed carry out due diligence.

29 This is a summary of the Joint Policy Note, Ensuring the proper implementation of the EU Regulation on the responsible sourcing of minerals from conflict-affected and high-risk areas, 25 April 2019.

4. CONCLUDING REMARKS

Both the Dodd-Frank 1502 and the EU Regulation aim to help break the link between income generated by the 3TG minerals trade and the perpetuation of armed conflict. Both pieces of legislation are doing so by imposing obligations with regard to 3TG minerals supply chain due diligence. However, there are important differences in the obligations set by the two downstream regulations.

Dodd-Frank 1502 is a law concerning the disclosure of supply chain due diligence information. The EU Regulation puts the emphasis on a good supply chain due diligence system by making the OECD Guidance recommendations mandatory. Another major difference is the geographical scope: Dodd-Frank 1502 is specifically targeted towards 3TG minerals from the DRC and neighbouring countries. While the EU Regulation covers 3TG minerals sourced from all conflict-affected and high-risk areas.

Additionally, both laws target different types of companies. Dodd-Frank 1502 concerns companies trading on US stock exchanges that use 3TG minerals in products they manufacture. Hence, it targets many major corporations and brands. The EU Regulation exempts companies using 3TG minerals in manufactured products. The vast majority of EU companies do use the 3TG minerals, but they are importing them beyond the metal stage and, therefore, fall outside the scope of the EU Regulation.

Dodd-Frank 1502 created momentum to increase efforts that addressed conflict financing from mineral exploitation and trade. At the same time, increased scrutiny on conflict financing led most international mineral traders to abstain from sourcing minerals from the DRC, the so-called *de facto* embargo. The EU Regulation, with its differences compared to Dodd-Frank 1502, is seemingly designed so as to avoid or at least minimize the risk of a *de facto* embargo. Nevertheless, caution is needed in this regard. Instead of abstaining from sourcing from one country, the EU Regulation risks that companies in Europe abstain from sourcing ASM from CAHRA's.

In order to avoid a disengagement from ASM produced in CAHRAs, a market for responsible 3TG minerals from CAHRAs needs to be created, among others by creating (economic) incentives for operators to engage in CAHRAs and through private and public investments in due diligence initiatives. The accompanying measures to the EU Regulation are an essential contribution to the latter. Alongside the efforts to formalise the ASM sector, we argue that the EU should concurrently focus on familiarizing producing countries with provisions of the EU Regulation. Without the familiarization with, and subsequently the needed adaptations to the requirements of the EU Regulation at the local level, it will be much harder for Union importers to meet their mandatory due-diligence requirements.

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