Why Manufacturers Should Follow the Development of Proposed European Union Conflict Minerals Regulations

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On March 5, 2014, the European Commission (Commission) set forth its long-awaited draft proposal for a new European Union (EU) "system for supply chain due-diligence" for the responsible sourcing of certain minerals originating in "conflict affected and high-risk areas." The proposal shares some similarities with the provisions of the Conflict Minerals Rule promulgated by the U.S. Securities and Exchange Commission in response to Section 1502 of the Dodd-Frank Wall Street Reform Act, but differs in many key aspects.

First, it is critical to recognize that this is a proposal. The European Parliament and the Council of the European Union will consider and likely amend the proposal. It is estimated that the proposal will not be adopted until at least 2015 and most likely not for two years. However, parties interested in expanding the scope of the rule and increasing the reporting burdens will attempt to do so during the deliberations by the Parliament and Council starting this year. **Those who have a stake in maintaining the proposal in its present form or in shaping the proposal to be even more reasonable should monitor developments throughout the legislative process and take every opportunity to provide input.**

What Minerals and Products are Covered?

Only tin, tantalum, tungsten and gold, the 3TGs, and their ores are covered. There had been concerns that the Commission would attempt to expand beyond these same four minerals, termed the 3TGs, covered by the SEC's Conflict Minerals Rule. They did not. More importantly, only the ores, concentrates, oxides, etc. and a limited list of specific metal products such as bars, rods, profiles, wire, powders, sheets, strip, foil, imported into the EU are covered. Other base metals containing these four minerals as alloying elements and downstream products containing the metals are not included. The Commission seeks to focus upstream on the smelters and refiners with the objective of developing a list of "responsible smelters and refiners."

Who is Covered?

The proposed regulation only applies to importers of the 3TG minerals and ores, and the program is voluntary - it sets up a system for supply chain due diligence "self-certification." Under the proposal, an importer would self-certify to a Member State competent authority that it adheres to the supply chain due diligence obligations set out in the regulation. The importer thus becomes a self-certified "Responsible Importer." The regulation sets forth numerous requirements that the Responsible Importer must meet, including internal management systems, supply chain engagement mechanisms, chains of custody, traceability systems, risk management obligations, third-party audits, and disclosure/transparency obligations.

What are the Reporting Obligations and Who Must Report?

Uder the SEC Conflict Minerals Rule, the reporting obligations fall on publicly-traded companies, about 6,000 of them. In many cases this means end product manufacturers. The result is a lengthy and near impossible supply chain tracing effort from end product to smelter and mine. The Commission tried to avoid this by placing the reporting burden on the EU importer of the ores and metals, not the products containing the metals, thus shortening the supply chain dramatically and limiting the potential number of reporters to the estimated 400 importers in the EU. However, it appears that, much like Dodd-Frank, the regulators expect downstream, branded product makers to apply pressure up the supply chain to force importers to participate so that the branded companies can claim that their products are conflict-free. To this end, the rule places considerable disclosure requirements on the Responsible Importer, including making available to it downstream purchasers information obtained from its supply chain due diligence. Further, the Responsible Importer must make publicly available the results of its supply chain practices as widely as possible.

What Geographic Areas are Considered to be "In Conflict?"

In sharp contrast to Dodd-Frank, the proposed EU regulation is “global in scope” and follows the Organization for Economic Cooperation and Development (OECD) Due Diligence Guidelines in this respect. The draft regulation includes the key phrase: “conflict-affected and high-risk areas.” These 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.” Amazingly, it appears that the Responsible Importers who are subject to the rule are the ones who will make the determinations whether countries are “conflict-affected or high-risk areas,” using international templates to help guide business decisions in collaboration with other companies and organizations. The regulation is intentionally vague on this point to avoid the de facto embargo that Dodd-Frank has created for DRC conflict minerals.

How will the Rule be Enforced?

The focus in the proposal is on incentives and reliance on markets. From the program, the EU will develop a list of responsible smelters and refiners, including Responsible Importers. The rule provides an estimate of 400 importers of 3TGs into the EU. The system of self-certification will be enforced by the Member States. An importer volunteers to participate and self-certifies. The Member State audits. If non-compliance is found, a notice of remedial action is issued to the importer, and if not followed, the importer is removed from the list of “responsible smelters and refiners.” Presumably then, product the importer sells downstream cannot qualify the downstream user to certify its product as “conflict-free.” The EU intends to use public procurement options, i.e. its purchasing power, to reward product manufacturers who can demonstrate that their products contain minerals sourced from Responsible Importers. Thus, in a fashion similar to Dodd-Frank, the EC expects the end-product manufacturer to apply pressure up the supply chain. The difference is, the importer is the focus of the regulation.

The Legislative Process

The Parliament’s International Trade Committee will be responsible for acting on the proposal, including consideration of opinions that may be provided by the Development Committee and the Committee on Industry, Research and Energy. The Foreign Affairs Committee already has decided that it will not issue an opinion. The political process of assigning Parliamentarians who will be responsible for drafting the opinions and coordinating proposed amendments is underway now.

Initial input also will be obtained from the 28 Member States of the European Union. Next steps depend on whether the European Council (representing the 28 Member States) agrees with the Parliament's amendments. The process may continue where consensus is not found until the (revised) proposal is ultimately adopted or rejected.

Because of the May 2014 elections to create a new European Parliament (2014-2020), it is unlikely that detailed work on the proposal will begin until the fall.

What to Look For Now

As proposed, the regulation is voluntary and reasonably narrow in scope as to product and entity covered while broad enough to have a significant limiting impact on funding of conflicts. The product is limited to tin, tantalum, tungsten and gold metal and their ores imported into the EU. While this definitely excludes alloys, intermediate and finished products containing these metals, **interested parties should remain very cautious and vigilant in following the development of the proposed regulation because a change during European Parliament and Council deliberations could alter that.** There are those who would like to see it broader. Even more reasonable is the Commission's focus on upstream importers who are closest to the smelters and refiners and who are limited in number to 400. It is not entirely clear what is expected of downstream users. In any event, that role could be greatly expanded during European Parliament and Council deliberations, unreasonably burdening tens of thousands of additional manufacturers with reporting requirements, as in Dodd-Frank, with no additional benefit. It will behoove those manufacturers to follow the European Parliament and Council closely as they take action on the proposal.