Client Alert

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European Proposal for a Voluntary Self-Certification Scheme on Conflict Minerals

More than four years after the United States adopted the Dodd-Frank Wall Street Reform and Consumer Protection Act mandating the Securities and Exchange Commission (SEC) to adopt rules regarding minerals from Congo or adjoining countries, the European Commission proposed a programme for conflict minerals. Compared to the US regime, the EU programme has a broader geographic scope. Unlike the US regime, however, the EU programme is voluntary and employs an opt-in mechanism.

The proposed EU regime builds not only on the US conflict mineral rules, but also on international standards, in particular the OECD's Due Diligence Guidance. Geographically, the EU rules would extend beyond central Africa, which is the only region subject to the US rules, to other conflict regions, such as Latin America, Myanmar and Afghanistan.

US Conflict Mineral Rules

In August 2012, pursuant to Section 1502 of the Dodd-Frank Act, the SEC adopted final rules on conflict minerals. The rules were challenged and are being challenged before the US Court of Appeals for the DC Circuit. In the meantime, the SEC rules will remain in effect unless stayed by the court.

Under the conflict minerals rules, public companies that manufacture certain products in which so-called conflict minerals sourced from central Africa are present must provide detailed reporting about their supply chain. Conflict minerals are defined to include "(A) columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives (such as tin and tungsten); or (B) 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."

The first reporting deadline under the SEC rules is June 2, 2014. With the deadline rapidly approaching, the judgment of the US Court of Appeal for the DC Circuit is eagerly awaited. In addition to arguments relating to the administrative burden imposed by the SEC conflict minerals rules, the court will also have to decide whether the rules compel speech in violation of companies' right to freedom of speech under the First Amendment. Given that both the timing and the contents of the court's judgment are uncertain, companies subject to reporting cannot avoid making efforts to comply. For further information, please refer to our client alert entitled "Recommendations for Companies Pending Appellate Review of the SEC Conflict Minerals Rules."

Draft EU Conflict Mineral Rules

The European Commission's proposed regulation involves a voluntary, opt-in self-certification scheme for EU importers. Because it is not a legally binding instrument, it is not self-evident that companies will comply. The Commission expects that compliance incentives will arise from public pressure, public procurement criteria and special funding that will be made available for small and medium-size enterprises.

The proposed regime applies only to importers, i.e. companies that place raw materials on the European market. Importers of final products incorporating minerals, such as laptops and mobile phones, are not covered. By targeting the scheme narrowly, the Commission intends to make the supply chain more transparent for downstream purchasers of metals, thus assisting them in their due diligence efforts.

The proposal covers the same four minerals that fall under the US conflict rules, i.e. tin, tungsten, tantalum, their respective ores and gold. Despite calls by interests groups, the Commission decided not to include other conflict materials such as emerald, ruby and diamond. These materials are already regulated by the Kimberley Process Certification Scheme, as the Commission points out. This leaves open the possibility, however, that future EU conflict minerals legislation will also extend to these minerals.

EU importers that decide to participate in the self-certification scheme must (i) create a management system that is capable of tracking the origins of purchased minerals, (ii) adopt risk management procedures that address and mitigate the adverse impact from the financing of armed groups via the supply chain and (iii) provide for third-party auditing and supply chain information that should be accessible to downstream purchasers and the public. Risk management procedures should include whistleblowing schemes. Participating importers will be rewarded by their inclusion in a list of responsible importers, which will be published annually.

The geographical scope of the Commission's draft regulation is unlimited and covers tin, tantalum, tungsten, their respective ores and gold, from all 'conflict-affected and high-risk areas'. Listing of conflict countries is not provided to avoid unintended socio-economic consequences for civilians caused by companies that might leave the regions concerned to easily ensure compliance.

Enforcement of the self-certification system will be carried out by designated national authorities in the Member States. Importers that opt to participate in the voluntary scheme but subsequently infringe its provisions will receive a notice of remedial action by national authorities and may, if non-compliance persists, be removed from the above-mentioned responsible importer list.

The Commission's proposal is based on the following six principles:

1. ***Comprehensive approach***: The proposed solution takes into account the whole context and provides a comprehensive approach to the problem. Accordingly, the intent is that the conflict rules will be integrated into wider peace and development strategies that address poverty, weak states, and ethnic or ideological conflicts.

2. ***Compatibility with existing approaches***: As noted above, the Commission's proposal builds on the OECD's Due Diligence Guidance and Section 1502 of the US Dodd-Frank Act. This way, the Commission hopes to minimise incompatibilities and duplications. In addition, the EU initiative supports already existing compliance efforts by European companies that are subject to US regulatory obligations.

3. ***Do no harm***: With this proposal, the Commission intends to avoid creating incentives for companies to withdraw completely from minerals business in conflict regions. Due to the great dependence of many countries on resource trade, any complete withdrawal of companies from conflict minerals region could significantly impact local populations. Instead, the proposal is aimed at creating incentives for companies to collaborate more closely with primary producers, in order to demonstrate that their suppliers are not involved in the conflict minerals trade.

4. ***Global scope***: Unlike Section 1502 of the US Dodd-Frank Act, the proposed EU rules are not limited in their application to conflict minerals from central Africa but apply to tin, tantalum and tungsten metals and ores, and gold, from all 'conflict-affected and high-risk areas'. A broad

coverage is deemed necessary to provide for effective regulation of conflict minerals and to avoid stigmatisation and isolation of certain regions.

5. ***Targeted approach***: With the proposed regime, the Commission intends to provide incentives to smelters, the "narrowest point in the supply chain". to carry out due diligence. Usually, the smelting process is the last phase in the supply chain at which the minerals' origins are still traceable. The Commission therefore wants smelters to feel commercial pressure to improve the quality and transparency of information collected on their supply chains.

6. ***No unintended consequences***: The EU initiative is intended to avoid any risk to the security of supply for the EU. Many European industries are dependent on the supply of covered minerals and a reduction in sourcing from conflict regions could significantly impact the European economy.

Impact of the proposed legislation

The EU initiative could potentially apply to about 400 European smelters and importers and indirectly affect 800,000 European companies trading in the relevant minerals and metals. Currently, only 12% of relevant European companies are believed to conduct conflict minerals due diligence. The Commission hopes to double the number of European companies conducting such due diligence.

The EU initiative is intended to complement Section 1502 of the US Dodd-Frank Act by addressing its principal shortcoming: the supply chain communication from the upstream to the downstream part of the chain. The measures undertaken by EU importers to obtain certification should make the supply chain more transparent and thereby assist downstream companies in carrying out their own supply chain due diligence.

Unlike Section 1502 of the US Dodd-Frank Act, the Commission proposal is based on a voluntary scheme, and thus not legally binding on targeted companies. Its effectiveness will therefore chiefly depend on the strength of the incentives for EU importers to sign up. It remains to be seen how strong the incentives arising from the listing of participating companies will be. A list of EU and global responsible smelters and refiners will be published in cooperation with the EU, which has the potential to raise public awareness and may put pressure on downstream firms to use conflict-free minerals. Note that the Commission previously decided to change its public procurement criteria to exclude products that do not respect OECD or equivalent due diligence guidance. It is conceivable that the EU Member States will follow the Commission's example and create additional incentives for compliance with the regulation.

Judging from US experience, it is expected that participating importers will have to invest resources in collecting and analysing the required information regarding their supply chains and sources of supply. The EU regime may well result in compliance challenges due to the difficulties for the mineral industry in tracing materials from conflict regions. Non-participation and non-compliance, of course, may also involve cost if market demand shifts towards participating suppliers.

Next steps

The Commission proposal will be submitted for review and approval to the Council of the European Union and the European Parliament. If these institutions agree with the proposed regulation, it could be adopted as early as September 2014. The certification scheme would then become operational in 2015.

This initiative may be followed by further proposals. As a recital of the draft regulation suggests, the Commission should propose legally binding rules, if it considers compliance with its voluntary scheme insufficient.

How Hunton & Williams Can Help

Hunton & Williams has extensive experience in assisting clients with financial disclosure and supply chain management. We advise clients on a wide range of regulatory matters, including compliance management, liability assessment, inspections and enforcement, and legal remedies. Working closely with our clients and with regulatory and technical experts, we ensure that our clients' interests are effectively protected.

Hunton & Williams is a global law firm with a strong focus on regulatory law and with qualified and experienced lawyers on both sides of the Atlantic, and in its offices in Brussels, Richmond, Washington, D.C. and Beijing offices.

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