18a/2017 POLICY NOTE

EU regulation on “conflict minerals” – a step towards higher accountability in the extractive sector?[1]

Karin Küblböck, Hannes Grohs

“No blood in my cell phone” – In the early 2000s, NGO-campaign slogans pointed out the links between raw materials in electronic products and the financing of war in the Democratic Republic of the Congo (DRC). These campaigns increased public awareness of the responsibility of companies for their supply chain. On July 9, 2017 an EU regulation came into effect that aims to prevent companies from financing armed conflicts via their procurement of raw materials. Even though the regulation can be considered a step in the right direction, many questions remain unanswered.

Increasing demand for mineral resources and complex value chains

Demand for mineral resources has heavily increased during the last two decades. The two main reasons are the strong economic growth of so-called emerging economies – above all China – and technological innovations e.g. in the electronics industry, which is characterized by highly complex value chains. For instance, a smartphone contains up to 50 different metals. Their extraction all too often takes place under socially and ecologically problematic conditions. In many countries, mineral resources are extracted by artisanal miners and frequently sold to companies via non-transparent channels. The extraction of resources has repeatedly caused serious human rights violations and access to raw materials is often a major factor when it comes to the escalation of conflicts.

In recent years, public awareness of the responsibility of companies for their supply chain has increased. In this context, a number of regulations and initiatives have been created with the aim of enhancing transparency in the extractive sector. The UN Guiding Principles on Business and Human Rights (UN 2011) addressed for the first time the responsibility of companies to respect human rights throughout their value chain. At the same time, increasing evidence of illegal resource exploitation in financing armed groups involved in the war in the DRC led to the emergence of various initiatives aimed at curbing the trade in “conflict minerals”. At the core of these initiatives lies the establishment of due diligence requirements for companies in order to prevent causing or promoting armed conflicts or violation of human rights by their procurement of raw materials.

Origins of the term “conflict minerals”

The term conflict minerals was coined during the war in the eastern part of the Democratic Republic of the Congo (DRC), which is considered one of the most brutal wars since the Second World War. The DRC is one of the resource-richest countries, which has strongly impacted its history. Since colonization, developments within the country have been marked by the importance of access to resources and their extraction. After the end of the Cold War, longtime dictator Mobuto lost his importance as an ally to the West and was replaced in 1997 by opposition leader Laurent Kabila after the First Congo War. During the 1990s the eastern provinces of the DRC had experienced increased political unrest and conflicts, especially after the genocide in Rwanda, which had caused the flight of over one million people from Rwanda to the DRC. In 1998, the Second Congo War broke out starting in the east of the country. The origins and dynamics of the war were complex and involved virtually all the neighboring countries. While at the beginning of the war the Western public paid little attention to the conflict, this changed in the early 2000s, with increased reports of armed groups being financed by illegal revenues from raw materials. Especially NGOs contributed to a growing public awareness. Their campaigns indicated the link between everyday electronic products and the war (Schwela 2013; Cuvelier et al. 2014).

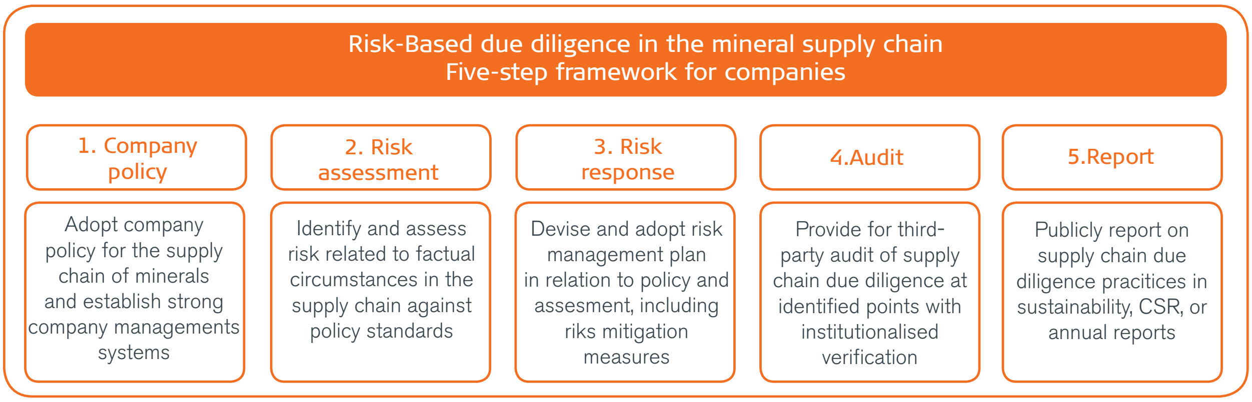
1 This Policy Note is a translated and updated version of ÖFSE Policy Note 18 (www.oefse.at/publikationen/policy-notes/)

OECD guidance

After a two-year stakeholder process the OECD adopted the Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High Risk Areas in 2011 (OECD 2016). Its intention was to assist companies in implementing due diligence practices with regard to their procurement of raw materials. In a five-step process, companies have to implement different measures to identify risks along their value chain and to react appropriately (see Figure 1).

Even though the OECD guidance is not legally binding, it is an important reference document and serves as a basis for further regulatory initiatives within the sector. The guidance refers to all conflict-affected and high-risk areas and to all minerals that contribute to the financing of conflicts in those areas.

Figure 1: OECD Due Diligence Framework



Source: OECD (2016)

US legislation on “conflict minerals”

The USA has assumed a pioneering role with respect to the implementation of the OECD guidance. In 2012, section 1502 of the Dodd-Frank Act came into force. It obliges companies listed on the stock market to determine on a yearly basis whether their products contain conflict minerals or not. The definition of conflict minerals applies to tantalum, tungsten, tin and gold (the so-called 3TGs) originating in the DRC or its neighboring countries. Companies issuing products that contain at least one of these minerals have to publish a report, in which they describe all the measures they took and are taking to comply with due diligence obligations. The reports have to be approved by independent third-party audits. However, loopholes weaken the traceability of the supply chain. In 2015, approximately two thirds of the companies handing in a report declared themselves unable to identify the country of origin of the respective minerals. Another 40% were not able to declare the smelters that form part of their supply chain (Bayer 2016). While a number of NGOs criticize the US legislation for being not strong enough, even the current version has been called into question. In early 2017, the acting chairman of the US Securities and Exchange Commission (SEC) asked for comments, whether the legislation and its provisions are still appropriate or should be relaxed (SEC 2017a). This has happened in a context in which the Trump Administration has clearly articulated its disapproval of the legislation. After a leaked draft of a presidential executive order, which contained a two-year suspension of section 1502, the so-called Financial Choice Act passed the House of Representatives on June 8, 2017 with the votes of the Republican Party. The bill, which is currently progressing to the Senate, would reverse much of the Dodd-Frank Act and repeal amongst others the complete section 1502 (Thomas 2017). Even though the act is not likely to pass the Senate in its current form due to disapproval by the Democrats, the future of section 1502 and therefore of the US legislation on conflict minerals is uncertain.

Figure 2: Value chain of mineral resources

Source: European Commission (2017)

The EU’s regulation on conflict minerals

Triggered by the US legislation on conflict minerals, pressure to take regulatory action was also raised in the EU. In March 2014, the EU Commission published a first draft of a regulation, which differed in three aspects from the US legislation. Firstly, the draft did not include any restrictions concerning its geographical scope. Instead of including only the Great Lakes region as in the US legislation, it referred – in alignment with the OECD guidance – to all conflict-affected and high-risk areas. Secondly, the draft contained only a voluntary (instead of a binding) self-certification of firms. Finally, it exclusively applied to importers of minerals and metals and thereby excluded importers of semi-processed and finished products containing the minerals. In May 2015, the EU Parliament opted for a substantial revision of the Commission’s draft. It demanded a legally binding implementation of the regulation. It also demanded to extend applicability to all companies that introduce products containing conflict minerals to the EU market for the first time. This should exert pressure on non-European companies further down the value chain to also implement due diligence requirements. In December 2015, the EU member states agreed upon a Council position that basically confirmed the original proposal by the Commission.

After months of debate, a compromise was announced at the end of 2016 and the final regulation came into force in July 2017. The regulation introduces – as suggested by the Commission and the Council – due diligence requirements only for the upstream industry (importers of raw materials and smelter products – see Figure 2) but not for importers of semi-processed and finished products containing the respective minerals. However, the implementation of the due diligence requirements will be legally binding as demanded by the European Parliament. In accordance with the US legislation, the EU regulation applies to the minerals tantalum, tungsten, tin and gold. Companies will have to carry out supply chain due diligence from January 1, 2021 onwards. The transition period of four years aims to provide member states with sufficient time to select competent authorities that implement and execute the regulation on the one hand and to allow companies to establish appropriate structures and procedures on the other.

The devil is in the details

The establishment of legally binding due diligence measures concerning the imports of raw materials may be considered an important step towards increased responsibility of companies for their supply chain. However, by restricting the applicability of the regulation to importers of non-processed raw materials – and only to four minerals – an opportunity was missed to compel more companies to assume their responsibility for their supply chain. Currently, the great majority of companies importing products containing the 3TGs are exempted from any due diligence requirements.

Most of the companies affected by the current version of the EU regulation are also covered by section 1502 of the Dodd-Frank Act and already apply due diligence measures. This begs the question of the need for a four-year transition period. Additionally, the effectiveness of the regulation strongly depends on its implementing provisions concerning inter alia the selection and definition of “conflict-affected and high-risk-areas”, the determination of threshold values for imports and the recognition of already existing supply chain due diligence schemes.

Definition of conflict-affected and high-risk-areas

Contrary to the US legislation, the EU regulation applies not only to the DRC and its neighboring countries, but to all conflict-affected and high-risk-areas. To determine these areas, the EU calls “upon external expertise that will provide an indicative, non-exhaustive, regularly updated list” (article 14). The selection of these experts is not yet defined and the definition of conflict-affected and high-risk-areas (see article 2f) still vague. Critics state that such a list involves the risk of stigmatizing certain regions and thus dissuading companies from sourcing from there. They regard the decision to list or not list a country as highly political with possible diplomatic and economic implications and demand that companies apply due diligence measures in all their procurement activities irrespective of the regions they source from, as proposed by the OECD guidance (EurAc 2016). However, representatives of companies point out that the implementation of due diligence measures would not be possible without such an indicative list.

Threshold values

The regulation will apply only to those importers of raw materials whose imports exceed a certain annual threshold value. EU member states voiced their support for such a provision arguing that small enterprises would be overburdened by fulfilling due diligence obligations. All thresholds should be set at a level that assures that “the vast majority, but not less than 95%, of the total volumes imported” is still covered by the regulation (article 1(3)). The current version of the regulation however will likely fail to do so. The threshold for gold for instance amounts to 100kg/year. This would allow a dentist, who is – according to the arguments – intended to benefit from the exceptional provisions, to prepare 25,000 fillings of gold within a year. Critics underline that in general up to 90% of importers of gold would be exempted from the regulation (Eur*Ac* 2016, Global Witness 2016). However, the Commission is going to revise the threshold values. A delegated act has to be adopted no later than July 1, 2020 (Article 1 (4)). The Commission is empowered to amend the existing thresholds every three years (article 1(5)). The threshold levels are going to be of central importance for the effectiveness of the regulation.

List of global smelters and refiners

The regulation stipulates that competent authorities in member states are responsible for carrying out appropriate checks to ensure that companies comply with due diligence obligations (Article 11). Smelters and refiners located in the EU must therefore comply with these provisions. Smelters outside the EU are affected indirectly, as Europe-based companies importing the respective raw materials have to apply due diligence requirements. For these non-European smelters and refiners, the EU regulation provides for a white list (Article 9). European companies importing raw materials from listed smelters do not have to carry out further due diligence measures. In order to be listed, smelters have to be members of an existing supply chain due diligence scheme. However, which schemes classify as appropriate has not been specified yet. Currently, an additional review by the EU is not planned.

Accompanying measures

Parallel to its first draft of the regulation in 2014, the EU Commission published a joint communication "Towards an integrated EU approach of responsible sourcing of minerals originating in conflict-affected and high-risk areas" (EC 2014). The proposed measures include incentives for small and medium enterprises to implement due diligence obligations. The Commission promises complying companies financial support as well as preferential treatment in public procurement contracts. Furthermore, the Commission aims to intensify policy dialogues with third countries to encourage the integration of due diligence obligations into national legislations. Additionally, measures concerning development cooperation are suggested that strive – among others – for a better regulation of the artisanal mining sector.

Even though many accompanying measures are under debate, no indication of their concrete implementation or funding is given. Besides some exceptions (Germany, the UK and the Netherlands), there are no commitments by the member states concerning measures to improve the conditions of the artisanal sector on the ground. In 2016, in cooperation with local actors the Netherlands established a public-private partnership to support the implementation of the regulation not only in Europe, but also in the producing countries. European NGOs demand from the EU and its member states to take a more resolute course of action. They call for enhanced support on the ground combined with the integration of local actors and with policy dialogues with the governments of the region in order to strengthen governance in the sector (Eur*Ac* 2017).

Conclusion

The establishment of legally binding due diligence provisions for companies in the extractive sector can be considered an important first step and a potentially promising example for other sectors. The final wording of the detailed provisions will be of central importance for the effectiveness of the regulation and for the quality of the due diligence obligations.

An extension of the applicability of the regulation to importers of semi-processed and finished products as well as to a greater number of minerals would offer an additional opportunity to substantially enhance the transparency of the sector. Due diligence provisions should furthermore not be reduced to aspects of conflict financing but should also take the social and ecological conditions of raw material extraction into account in order to contribute to their improvement.

References

Bayer, Chris (2016): Dodd-Frank Section 1502 - RY2015 Filing Evaluation. Development International.

Cuvelier, Jeroen /Van Bockstael, Steven/Vlassenroot, Koen /Iguma, Claude (2014): Analyzing the Impact of the Dodd-Frank Act on Congolese Livelihoods. Conflict Prevention and Peace Forum, November 2014.

European Union (2017): Regulation of the European Parliament and of the Council of 17 May 2017 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas. (EU) 2017/821

European Commission (2017): The EU's new Conflict Minerals Regulation. A quick guide if you're involved in the trade in tin, tungsten, tantalum or gold. March 2017.

European Commission (2014): Responsible sourcing of minerals originating in conflict-affected and high-risk areas. Towards an integrated EU approach, Joint Communication to the European Parliament and the Council. JOIN(2014) 8 final.

EurAc (2017): New legislation on conflict minerals, a missed opportunity for the European Union? Press release, 16.3.2017.

EurAc (2016): European Regulation on the responsible sourcing of minerals: The EU is (once again) about to weaken the upcoming Regulation, Policy Briefing, November 2016

Global Witness (2016): Conflict minerals import loopholes would pay for 6.000 AK-47s. In: Euractiv.com, 8.11.2016.

Küblböck, Karin/Grohs, Hannes (2017): Konfliktmineralien: Auswirkungen der bisherigen Regulierungsinitiativen und Schlussfolgerungen für die Implementierung der EU-Verordnung. ÖFSE. Jänner 2017.

Küblböck, Karin/Pinter, Silke (2016): Konfliktmineralien: Möglichkeiten und Grenzen aktueller Regulierungsinitiativen. ÖFSE Briefingpaper 13.

OECD (2016), OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: Third Edition, OECD Publishing, Paris.

SEC (2017a): Reconsideration of Conflict Minerals Rule Implementation, US Securities and Exchange Commission, January 31, 2017. https://www.sec.gov/news/statement/reconsideration-of-conflict-minerals-rule-implementation.html

SEC (2017b): Statement of Acting Chairman Piwowar on the Court of Appeals Decision on the Conflict Minerals Rule, US Securities and Exchange Commission, April 7, 2017. https://www.sec.gov/news/public-statement/piwowar-statement-court-decision-conflict-minerals-rule

Schwela, Ulrich (2013). Tantalum: Back to the source, Mining Journal, 20.03.2014. https://www.mining-journal.com/emea/tantalum-back-to-the-source

Thomas, Dynda A. (2017): Conflict Minerals Rule – Will It Stay or Will It Go?, Squire Patton Boggs, May 11, 2017. http://www.conflictmineralslaw.com/2017/05/11/conflict-minerals-rule-will-it-stay-or-will-it-go/

United Nations (2011): Guiding Principles on Business and Human Rights HR/PUB/11/04

Karin Küblböck
Senior Researcher
k.kueblboeck@oefse.at

Hannes Grohs
Research Assistant
h.grohs@oefse.at

GEFÖRDERT DURCH DIE
ÖSTERREICHISCHE ENTWICKLUNGS ZUSAMMENARBEIT