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European Commission's proposal for a conflict minerals regulation envisions voluntary scheme



Unlike the U.S. conflict minerals rule, the EU's Proposed Regulation is, controversially, voluntary, allowing importers to self-certify their compliance. Dynda Thomas, Andrew Renacci and Katherine Llewellyn examine the Proposed Regulation.

In March, 18 months after the United States Securities and Exchange Commission ('SEC') adopted a conflict minerals rule, the European Commission released its own proposal for a regulation that would provide a European Union system for supply chain due diligence self-certification for importers of tin, tantalum, and tungsten, their ores and gold ('conflict minerals') originating in conflict-affected and high-risk areas (the 'Proposed Regulation'). This article summarises the Proposed Regulation, provides a comparison of the Proposed Regulation with the U.S. conflict minerals rule, and offers some insight into the legislative process for the Proposed Regulation in the coming months. In addition, this article provides an update on the legal challenge of the U.S. conflict minerals rule that is currently winding its way through the U.S. federal courts.

The European Union's conflict minerals Proposed Regulation

On 5 March 2014, the European Commission released the long-awaited Proposed Regulation, which would incentivise importers into the European Union ('EU') to opt-in to a voluntary self-certification scheme to confirm that their imports of tin, tantalum, tungsten, and gold are not contributing to armed conflict in weakened and high-risk areas throughout the world. The release of the Proposed Regulation follows many months of input from individuals and non-governmental organisations, including a public consultation (which closed in June 2013) and an impact assessment (dated September 2013) that was intended to identify the costs and benefits of a potential regulation.

In conjunction with the release of the Proposed Regulation, the European Commission acknowledged the impact that a self-certification scheme could have on the bottom lines of EU importers, specifically small and medium-sized enterprises. However, it also noted that a readily available list of responsible smelters and refiners could actually increase the global competitiveness of EU companies. According to its proponents, the Proposed Regulation is intended to complement, and not merely duplicate, the U.S. conflict minerals rule adopted in August 2012. Therefore, the Proposed Regulation differs from the U.S. conflict minerals rule in several material respects.

The Proposed Regulation provides that an EU importer of conflict minerals may elect to self-certify that it is importing those conflict minerals responsibly in accordance with the Proposed Regulation. Under the Proposed Regulation, conflict minerals are tin, tantalum, tungsten, and gold, regardless of their country of origin. Tin, tantalum, tungsten and gold are also referred to as '3T&G'. According to the European Commission's frequently asked questions ('FAQs') that accompanied the release of the Proposed Regulation, in order to responsibly import conflict minerals and to be able to self-certify, an EU importer must (1) set up management systems to track the origin of the conflict minerals purchased; (2) use risk-management procedures to reduce the risk that they are financing armed groups; and (3) carry out third-party audits of their supply chain information.

Management systems

To set up a management system that would comply with the Proposed Regulation, an EU importer must make publicly available a conflict minerals policy that includes the standards by which the supply chain due diligence is to be conducted. The EU importer's conflict minerals policy should ultimately be incorporated into its supply agreements. The EU importer then must allocate responsibility to senior management for overseeing its supply chain due diligence in accordance with its conflict minerals policy. The EU importer should also establish an internal mechanism that allows parties to come forward with concerns regarding its supply chain. Finally, the EU importer must operate a traceability system, which tracks information about the supplier and conflict minerals, including the name and address of the supplier, the country of origin of the minerals and description of the mineral. This information should be maintained for a minimum of five years.

Risk management

In addition to setting up a management system, an EU importer must undertake certain risk-management obligations in order to self-certify and responsibly import conflict minerals in accordance with the Proposed Regulation. After collecting information about its supply chain from its traceability system described above, the EU importer must identify and assess any risks in its supply chain. If risks of financing armed groups are apparent from this assessment, the EU importer should implement a strategy to respond to those risks. For example, the EU importer could continue trading with the identified supplier while implementing risk mitigation efforts, temporarily suspend future purchases from the supplier while pursuing risk mitigation efforts, or permanently refrain from trade with that supplier.

Third-party audit

Finally, the EU importer must carry out an annual independent third-party audit of its processes and disclose the findings. The purpose of the audit is to confirm that the EU importer's management systems and due diligence processes are conducted in accordance with the Proposed Regulation. No later than 31 March of each year, the EU importer must submit to the relevant EU authority information about itself, a self-certification declaration, its independent third-party audit, and information about its supply chain covering the previous calendar year period. In addition, the same information must be provided to the EU importer's immediate downstream purchasers. According to the Proposed Regulation, the European Commission would then gather this information from all reporting importers and publish a list of responsible smelters and refiners. This activity and disclosure of information is intended to facilitate the flow of information between importers and downstream customers.

Only after an EU importer has taken the steps described above will it be identified as a responsible importer in accordance with Proposed Regulation. After it is identified as a responsible importer, the EU importer will be subject to ongoing checks by the relevant authorities to confirm that it continues to comply with the Proposed Regulation. If the responsible EU importer fails to continue to comply with the Proposed Regulation, it will be removed from EU list of responsible smelters and refiners or the names of the smelters and refiners in its supply chain will no longer be recognised as responsible importers.

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Built into the European Commission's Proposed Regulation is a mechanism that requires the European Commission to review and report to the European Parliament and Council, starting three years after the Proposed Regulation becomes effective and every six years thereafter, about the effectiveness of the Proposed Regulation. This report is required to include the impact of any increased costs the Proposed Regulation is having on EU importers. The Proposed Regulation contemplates that based on this periodic review, the European Commission may, but is not required to, propose legislative amendments to the Proposed Regulation. Any such proposed amendments would be considered under the co-decision procedure, a potentially long and arduous process that is described in more detail below.

Differences between the EU Proposed Regulation and the U.S. conflict minerals rule

The Proposed Regulation differs from the U.S. conflict minerals rule in several material respects. The biggest difference, and perhaps most controversial, is that the Proposed Regulation is voluntary while the U.S. conflict minerals rule is mandatory. Under the Proposed Regulation, EU importers can choose to self-certify that they are responsible importers – it does not require them to do so. Unlike the Proposed Regulation, the U.S. conflict minerals rule requires a reporting company that manufactures or contracts to manufacture a product that contains necessary conflict minerals to disclose certain information about the use and origin of those necessary conflict minerals.

The voluntary nature of the Proposed Regulation has been criticised. Shortly after the release of the Proposed Regulation, Judith Sargentini, a Member of the European Parliament, said, 'Four years after Dodd-Frank, the European Commission is presenting us with a neatly gift-wrapped, empty box that will not help the Congolese people set up a sustainable mining industry, does not demand transparent trading by European companies, and leaves them instead to obey an unbalanced piece of American legislation.' Drafters of the Proposed Regulation responded that they did not want to create a *de facto* embargo of conflict minerals, which has

3T&G

Tin, tantalum, tungsten, their ores and gold are sometimes referred to as '3T&G' or 'conflict minerals'. These terms are used regardless of the country of origin of the ores.

been one unintended consequence of the U.S. conflict minerals rule.

A second important difference between the Proposed Regulation and the U.S. conflict minerals rule is that the Proposed Regulation is focused on the upstream portion of the supply chain, or the importers, while the U.S. conflict minerals rule is focused on the downstream portion of the supply chain, the manufacturers. The EU estimates that only approximately 400 importers are eligible to participate in the voluntary self-certification scheme. In contrast, the SEC has estimated that approximately 6,000 reporting companies would be subject to the U.S. conflict minerals rule reporting requirements. Drafters of the Proposed Regulation reasoned that they only want to complement the U.S. conflict minerals rule because it is estimated that approximately 175,000 European companies are in the supply chains of reporting companies subject to the U.S. conflict minerals rule and are therefore already indirectly subject to the U.S. conflict minerals rule.

Another difference between the Proposed Regulation and the U.S. conflict minerals rule is the geographic scope of the Proposed Regulation. The Proposed Regulation is global in scope, while the U.S. conflict minerals rule is focused only on central Africa. Under the Proposed Regulation, EU importers that choose to participate in the voluntary self-certification scheme are required to identify countries that are 'conflict-affected and high-risk areas'. The identities of countries that might qualify as 'conflict-affected and high risk' may change from day to day. While reporting companies subject to the U.S. conflict minerals rule, on the other hand, are required to report on conflict minerals that originate from specifically identified countries in central Africa.

The last major difference between the Proposed Regulation and the U.S. conflict minerals rule is that the Proposed Regulation contemplates providing incentives for participation in the self-certification scheme. The incentives under the Proposed Regulation include eligibility for EU public procurement contracts, financial support of the due diligence efforts of small and medium-sized enterprises, and visible recognition for companies that source responsibly. The U.S. conflict minerals rule contemplates required reporting and does not provide incentives for participation.

Status of the regulation

Now that the European Commission's Proposed Regulation has been released, what is the next step under the EU's legislative process? As you may recall, the SEC released its proposed draft conflict minerals rule in December 2010 and expected to adopt the final rule approximately five months later in April 2011. However, due to the number and breadth of comment letters received and the inherently controversial nature of what was proposed, the SEC did not adopt the final conflict minerals rule until 20 months later, on 22 August 2012. Observers are now wondering whether we can expect a similar extended timeline for the Proposed Regulation under the EU legislative process.

Co-decision

The FAQs provide that 'under co-decision, the European Parliament and the Council will take up the [Proposed Regulation]'. The 'co-decision procedure', which is also known as the 'ordinary legislative procedure', is the main law-making procedure for the EU.

The EU estimates that only approximately 400 importers are eligible to participate in the voluntary self-certification scheme.

For an act to be adopted under the co-decision procedure, it must be adopted by both the European Parliament and European Council.

First reading

The co-decision procedure for the Proposed Regulation began with the release of the proposal by the European Commission on 5 March 2014. After this proposal was made, the Proposed Regulation was submitted simultaneously for the 'first reading' to the European Parliament (consisting of members directly elected by the citizens of the Member States) and the Council (representing the governments of all 28 Member States). Upon receiving the Commission's proposal, the President of the Parliament passed it on to a parliamentary co-ordination committee which will prepare an opinion that may accept or reject the proposal or propose amendments to it. The International Trade Committee ('INTA') has been appointed as the parliamentary co-ordination committee for the Commission's Proposed Regulation. The rapporteur, the person responsible for preparing the opinion for the INTA, has not yet been appointed. After the draft committee opinion is prepared, it is then discussed at a plenary session of Parliament. The opinion must be adopted by a simple majority (i.e., a majority of members voting on the position). After adoption, the opinion is then sent to Council.

The Council can act in one of three ways. First, if the European Parliament does not amend the Commission's proposal, the Council can accept the proposal, at which point the proposal would become law. Second, if the European Parliament amends the Commission's proposal, the Council can accept all of the European Parliament's amendments, and the amended proposal would become law. Third, the Council can adopt its own position, known as a 'common position'. There is no time limit for this 'first-reading' stage.

Second reading

If the Council adopts its own position, it would send that revised proposal back to the European Parliament with a statement of reasons why it did not support the European Parliament's position as submitted. The European Parliament then begins its second reading. This second reading cannot take longer than three months plus a possible one-month extension. If the European Parliament approves the Council's position without change (by simple majority) or if the second reading time limitation expires and the European Parliament has not acted, then the Council's position will be deemed to have been adopted. Any amendments to the Council's position that are made by the European Parliament in the second reading must be approved by an absolute majority (i.e., a majority of the total number of members who comprise Parliament). In the alternative, if the European Parliament rejects the Council's position by an absolute majority, then the act will not have been adopted and the co-decision procedure ends.

If the Parliament adopts amendments, the Proposed Regulation would be sent back to the Council for consideration in its second reading. Prior to the Council deciding whether

to accept or reject the Parliament's amendment(s), the European Commission will deliver to the Council its opinion on such amendments. The Council's second reading may take no longer than three months plus a possible one-month extension. If the European Commission approves the Parliament's amendment, this second reading by the Council requires approval of the amended position by at least a qualified majority of the Council. In the Council, the number of votes allocated to a country (or 'voting weight') is proportionate to the size of its population. So, for example, Germany has 29 votes while Malta has only three votes. The total number of votes across all 28 Member States is 352. A qualified majority is reached when a majority of the 28 Member States vote in favour and at least 260 of the possible 352 weighted votes are cast in favour. Furthermore, a Member State can ask for a check to see whether the majority represents a minimum 62% of the total European Union population. If the European Commission does not approve the amendments, the Council must act by unanimity.

If Council's second reading time limitation expires and the Proposed Regulation was unable to garner the necessary approval, then Council and the European Parliament convene a Conciliation Committee to consider the Proposed Regulation. The Conciliation Committee works out the differences between the European Parliament's position and the Council's position, in the hope of agreeing upon a joint text to be considered at a third reading. If the Conciliation Committee is successful in drafting a compromise, with certain exceptions, the European Parliament (by simple majority) and the Council (by a qualified majority) have six weeks in which to adopt the act. If either of the parties fails to deliver the necessary approval within that six-week period, the procedure ends and the Proposed Regulation is not considered further.

Prospects for the final regulation

With the strong reaction against (a) the voluntary nature of rule and (b) the rule's focus on importers and not all companies, there is likely to be debate in both the Parliament and the Council and amendments to the Proposed Regulation. It would therefore not be surprising if the wording of the finally adopted legislative act (if adopted at all) were to be different from the Commission's Proposed Regulation. All this means that the breadth and details of the final rule are still very uncertain and companies cannot make definite compliance plans yet.

The time required for a proposal to become an act under the EU's co-decision procedure depends on many things, including whether there will be multiple readings between the European Parliament and the Commission, and whether a Conciliation Committee will need to be convened. Theoretically, the co-decision procedure could take only a few months, and an EU conflict minerals act could be adopted and signed into law by late 2014. However, the procedure could take several years if, as we suspect, the Parliament and the Council each adopt their own revisions to the Proposed Regulation and multiple readings are required. In addition, it is unlikely that Parliament and the Council will commence the process for review of the Proposed Regulation until after the European Parliament elections in May 2014.

U.S. conflict minerals rule legal challenge

Only a month after the SEC adopted the U.S. conflict minerals rule, business associations filed a legal challenge to the rule in U.S. federal court, requesting that the U.S. conflict minerals rule be vacated or at least modified. In January of 2014, the U.S. Court of Appeals for the D.C. Circuit heard oral arguments regarding the challenge to the U.S. conflict minerals rule. Counsel for the National Association of Manufacturers, the U.S. Chamber of Commerce, and the Business Roundtable urged the court to overturn the rule, arguing that the rule exceeds congressional intent and violates the First Amendment. The SEC defended the rule on the basis that it was merely carrying out Congress's mandate in the Dodd-Frank Act to create such a rule.

Based on their questioning during the oral arguments, two of the judges seemed receptive to the business groups' arguments. Judge David Sentelle, a President Reagan appointee, commented that, '[t]he disclosures seem more in line with a Federal Drug Administration requirement than the types of disclosures typically required by the SEC'. Judge A. Raymond Randolph, a President George H.W. Bush appointee, followed up by asking, '[u]nder your First Amendment theory…could Congress say that all companies now have to report the conditions under which their products are manufactured overseas, what the pay rate is, whether they are using child labor?'

Despite the tone of the questions, it is impossible to predict how the Court of Appeals will decide this case. In addition, it is impossible to predict when the decision will be made, but the general consensus is that the decision will be announced in April of 2014, which is just before the initial reporting deadline. If the legal challenge is successful, reporting companies will no longer be required by the U.S. conflict minerals rule to disclose their use and origin of necessary conflict minerals. However, even if the SEC rule is struck down in its entirety, companies would nevertheless be wise to consider the expectations of their customers, non-profit organisations, and activist consumers when deciding whether to make voluntarily disclosures about their sourcing practices. Furthermore, even if the Court of Appeals were to strike down the U.S. conflict minerals rule and the SEC does not challenge that decision, the SEC would be required to rewrite the rule because the Dodd-Frank Act requires the SEC to adopt a conflict minerals rule and the statutory directive would not be impacted by the conclusion of the current legal challenge. Regardless of the Court of Appeals' decision, the U.S. conflict minerals rule is not going away any time soon.

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