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How to Enforce Due Diligence? Making EU-legislation on "Conflict Minerals" Effective

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Recommendations

\ Mandatory due diligence requirements

To reach the objectives stated in the draft legislation, the European Union has to make due diligence on "conflict minerals" mandatory for EU companies. This will increase the demand for "conflict-free" minerals, which will act as an incentive for speeding up local mapping and tracing efforts and the return of smelters to the DR Congo.

\ Due diligence by end producers

Downstream companies are in a position to conduct due diligence with marginal to manageable costs, despite the complexity involved. The competitive disadvantage of European companies towards Asian companies is more imaginary than real.

\ Indispensable accompanying measures

For due diligence legislation to be effective in conflict regions, EU actors ought to support multi-stakeholder initiatives on the ground that have greater credibility than government or industry schemes.

\ Flexible mapping and tracing tools

Instead of rigid certification procedures that create high administrative burdens on state and economic actors, priority should be given to flexible and reliable instruments of mapping and tracing that smelters can use for their supply chain due diligence. In conflict regions, certificates risk being tainted by reports of fraud, as the challenges to governance can be expected to be similar to those in the Great Lakes region.

\ An enabling policy approach to artisanal mining

A policy approach that enables rather than prohibits artisanal mining is better suited to providing market access to informal artisanal mining that does not have links to armed actors. Legality should not be made a precondition for recognising artisanal mines as conflict-free to avoid punishment of an entire sector for the links to conflict financing of a few.

How to Enforce Due Diligence? Making EU-legislation on "Conflict Minerals" Effective

In the weeks and months ahead, the European parliament has a decisive role in reaching meaningful European legislation on the responsible sourcing of minerals from conflict regions. In mid-May 2015, it is due to vote on an EU regulation drafted by the European Commission. The stated objectives of the draft legislation are to (1) contribute to decreasing the financing of armed actors via the proceeds generated in the mining sector of conflict-affected and high-risk areas, by (2) enhancing the ability of EU downstream companies to conduct due diligence, with the effect of (3) contributing to reduced distortions in the mineral markets of the Great Lakes Region (European Commission, 2014, p. 32).

The Commission proposal for a EU regulation champions voluntary due diligence requirements for importers of tin, tantalum, tungsten (3T) and gold from all conflict-affected and high-risk areas. The latter are defined as areas identified by the presence of armed conflict, widespread violence, including violence generated by criminal networks, or other risks of serious and widespread harm to people, based on the OECD Due Diligence Guidance on Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas. The requirements to conduct due diligence with regard to conflict minerals in the Commission's proposal also follow the OECD Due Diligence Guidance.

The current discussion among European policymakers, industry and civil society groups is very much divided on the question of a voluntary or mandatory approach to due diligence and narrower or wider sections of the supply chains to be targeted. According to the Commission's impact assessment (2014), the rationale for a voluntary due diligence system is the following:

- Companies trying to conduct supply chain due diligence in compliance with the US Dodd-Frank Act[1] have encountered significant challenges.
- Official buyers have withdrawn from the Great Lakes region because of the DFA, causing the fall in local prices of the targeted minerals ("market distortions", *de facto* embargo).
- When forced again to conduct due diligence along the supply chain, companies are feared to withdraw even further from buying minerals from the Great Lakes region.
- Companies are still prepared to implement due diligence on a voluntary basis.

Contrary to the Commission's assessment, we argue that the fear of market distortions (the *de facto* embargo following US and Congolese regulations) can no longer be used to justify voluntary measures. What is at stake now, is the return of conflict-free smelters to the Democratic Republic of the Congo (DRC):

- Compared to mandatory rules voluntary measures have proven to be ineffective.
- Creating a market for conflict-free minerals can help to overcome the *de facto* embargo.
- Mandatory legislation is vital, as it increases the demand for conflict-free minerals.
- Without increasing the demand for conflict-free minerals (downstream), incentives to increase the supply may stagnate on the ground (upstream). Both fields of action—downstream and upstream—are thus mutually interdependent.
- Supply chain due diligence is feasible for downstream and upstream actors, as tracing schemes are being implemented globally and in the Great Lakes region. If the European Union and its members require companies to conduct due diligence and boost their support for mapping and tracing initiatives in conflict regions, the legislation can be effective in meeting its stated objectives.

This *Policy Brief* provides insights that support this argument. While searching for the best technical solution to enhance due diligence practices, it has to be kept in mind that due diligence alone cannot achieve the wider objective of furthering peace and security. EU actors should work towards this objective with a

[1] \ Section 1502 of the Dodd Frank Wall Street Reform and Consumer Protection Act (DFA) requires companies listed on the US stock exchanges to provide specific assurances that any products that they have manufactured or contracted to manufacture do not contain minerals that "originated from the DRC or one of its adjoining countries controlled by armed groups or financing those. Neither directly nor indirectly" (p. 842). The term "armed group" means "an armed group that is identified as perpetrators of serious human rights abuses" (DFA, SEC 1502, p. 843).

comprehensive peacebuilding agenda, which centres on the livelihood opportunities of the population of conflict zones.

Different context, different effects

The European Union need not be afraid of causing another *de facto* embargo. As context and content of EU legislation differ from section 1502 of the US Dodd-Frank Act (DFA), the effects will also differ.

Still, the current discussion about the mandatory or voluntary nature of EU legislation is informed by the perceived consequences of this earlier US legislation: The introduction of due diligence requirements for US-listed companies sourcing from the DRC and neighbouring countries, i.e. the Great Lakes region, has led to a deterioration in the economic and security situation in eastern DRC contrary to the hoped for end of conflict financing in that region. In fact, not all of the negative effects were directly caused by the DFA, as a ban on all mining activities was declared in parallel by the Congolese government, with tremendous consequences. But in the general perception, these are all consequences attributed to this US legislation.

The current global context is different from the situation in June 2010, when the US law was passed. Back then, many smelters stopped buying tin, tantalum and tungsten from North and South Kivu and Maniema provinces in the DRC, as the Congolese government had suspended mining activities in these provinces between September 2010 and March 2011. In addition, the implementing rules for the DFA were still unknown, creating uncertainties, while the option of buying minerals from other countries than the DRC and its neighbours ("DRC-free") existed. In combination, this caused the *de facto* embargo on Congolese minerals. So today, the question is about how to overcome that "embargo" and no longer about how to avoid it.

While challenges persist, sourcing responsibly is easier in the current context, because processes to trace and certify minerals are in place and partly operational in the Great Lakes region and globally. Due diligence requirements on responsible sourcing of minerals from conflict-affected regions thus no longer need to frighten companies as they did in 2010, when there was no supply of conflict-free minerals. Existing schemes and processes to trace minerals back to mines in eastern DRC include a mapping exercise that continuously monitors mine sites for the involvement of armed actors, the regional certification scheme of the Great Lakes Region that defined the criteria of conflict-free minerals, and the closed-pipe systems from mine to final product ("Conflict-free tin initiative" and "Solutions for Hope" for coltan).

The draft EU legislation is greater in scope, as it covers all conflict-affected and high-risk areas, while the DFA equates conflict minerals with minerals funding conflict in the DRC. Accordingly, companies could comply with the requirements of the DFA simply by stating that their products were DRC-free. This particularity of the DFA also explains in great part the *de facto* embargo on the DRC. By being global in scope, the draft EU regulation has made it much more difficult to simply withdraw from one region to fulfil due diligence requirements. The list of regions that potentially fall under the definition of conflict-affected and high-risk areas is rather long: For the year 2013, the Heidelberg Institute for International Conflict Research lists 68 cases of violent conflicts related to natural resources (www.hiik.de).

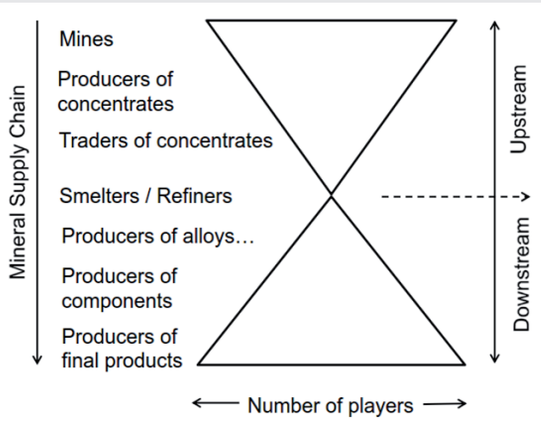
Supply chain due diligence can be complex, but it is feasible

Following European companies' complaints about challenges in conducting due diligence along the supply chain, the EU Commission opted for a policy option that incentivises voluntary due diligence by importers of minerals and metals (semi-finished goods). This considerably reduces the effectiveness of the legislation: the number of European companies targeted would be just around 500, as the number of economic players is much smaller at the beginning than further down the supply chain (end-producers) (see Figure 1). EU legislation could affect "up to

800,000" companies (European Commission, 2014, p. 79), if it extended requirements to end-producers within the industrial sectors that process tin, tantalum, tungsten and gold.

In fact, companies situated at the downstream part of the supply chain—from producers of alloys to producers of final products—do not need to trace the origin of minerals they use to comply with due diligence requirements. All they need to do is to identify the smelters in their supply chain and ask for conflict-free guarantees from them, including information on the region of origin of the minerals. Smelters (of the 3Ts) and refiners (of gold) are the choke points in the supply chain because once smelted or refined, minerals can no longer be traced to their origin.

Figure 1
Upstream and downstream segments of the mineral supply chain



Source: Manhart, A. (2013). Conflict Minerals. An evaluation of the Dodd-Frank Act and other resource-related measures. Presentation by Öko-Institut at Brussels, 3 September 2013, p.20. (http://www.oeko.de/oekodoc/1819/2013-491-en.pdf)

The complexity of the task for some large companies cannot be denied. One challenge prominently cited in the EU Commission's impact assessment are multi-tier supply systems, i.e. companies with several sub-suppliers that have no direct contact to smelters and the many products (inputs) that need to be traced. The complexity is, however, greatly relativised when the following facts are considered:

- Complete technical software solutions to implement due diligence for conflict minerals have been made commercially available. They automatically collect responses from all suppliers of a company.
- The bigger the company the more complex the supply chain. At the same time, larger companies incur less relative costs of conducting supply chain due diligence.
- Regardless of conflict minerals legislation, some companies need to know the origin of the minerals used for their products for reasons of quality assurance.

Despite the fact that "high costs" are prominently cited as one of the major reasons to back away from mandatory legislation, the estimates of costs for supply chain due diligence are rated as "marginal" to "manageable" by most respondents to a survey commissioned by the European Commission in 2013. Business respondents—the majority of whom were either end-producers or manufacturers of semi-finished products—estimated expenditures predominantly at €13,500 for initial efforts and €2,700 for subsequent ongoing efforts. This corresponds to 0.014% (initial costs) and 0.011% (annual recurrent costs) of turnover (European Commission, 2014). Most respondents were users of the automated software tool for conducting due diligence.

SMEs are able and not unwilling per se to conduct conflict minerals due diligence

While the protection of small and medium-sized companies (SMEs) is used as a main argument in favour of preventing mandatory rules, those SMEs who participated in the public consultation organised by the European Commission (July 2013) were quite open to the idea of binding legislation. Interestingly, 60% of large companies were against mandatory rules, whereas 48% of medium-sized and 52% of small companies were in favour (European Commission, 2014). Importantly, smaller companies face less complexities in their supply chain, although they incur higher relative costs when conducting due diligence than larger businesses.

The weak bargaining position of SMEs when requesting information on conflict minerals from their suppliers is another recurring theme evoked by opponents to mandatory EU due diligence requirements. Mandatory legislation could strengthen the bargaining position of European companies requesting information from their non-European suppliers, as the European Union is a relatively large importer of 3Ts and gold metals with a 23% and 13% share of global trade respectively (European Commission, 2014). In addition, the EU Communication that lays the ground for the draft regulation and accompanying measures ("JOIN (2014) 8 final") already foresees funding possibilities for the self-certification scheme of SMEs to be explored within the Competitiveness of Enterprises and SME's Programme (COSME).

The competitive disadvantage for European companies is more imaginary than real

European companies claim a competitive disadvantage as compared to operators in countries such as China, Malaysia, Indonesia, and Brazil where most of the economic actors are reported to continue to source from conflict areas without exercising due diligence. This statement ignores the fact that suppliers of US-listed companies—both manufacturers and smelters—are already under pressure to implement conflict minerals due diligence. There is only one European tin smelter among those certified through the Conflict-Free Smelters Program (CFSI). Most certified smelters are based in Asia, which is home to about 65% of the 280 known smelters worldwide for tin, tantalum and tungsten. Moreover, with mandatory due diligence requirements for European smelters, EU downstream companies could better serve US clients' due diligence requests, keeping them from turning to other compliant suppliers.

Voluntary due diligence requirements are not effective

Mandatory requirements appear necessary because the majority of companies do not voluntarily apply conflict minerals due diligence along their supply chains. A 2013 study by SOMO found only limited spin-off effects of the DFA: European companies that are not required to address conflict minerals by law (i.e. not US-listed) and those that are no direct suppliers to US manufacturers hardly take any steps to ensure that their supply chains are free of minerals that contribute to armed conflict and grave human rights abuses. While some large brands implement comprehensive due diligence along their supply chains, the majority of European companies who use the four minerals do not yet seem to feel the necessity. But this is bound to change when more Asian suppliers to US-listed companies start to implement Dodd-Frank rules, and European companies wanting to supply metals, components, or machinery to these manufacturers cannot compete.

Only very few companies of those addressing conflict minerals actively source non-conflict minerals from the Great Lakes region, according to a 2013 study by Öko-Institut. Smelters and refiners that are certified through the Conflict-Free Smelter Program (CFSI), World Gold Council or the London Bullion Market Association, use management systems that avoid any sourcing from the DRC or any adjoining country.

Hence, to substantially increase the number of European companies conducting supply chain due diligence, European legislation needs to be mandatory and to cover more sections of the supply chain than purely the importer level. The more companies conduct due diligence, the more difficult it will be to avoid buying minerals from the DRC—particularly Congolese tantalum, which represents about 15 to 20% of the world's supply.

EU support for mapping and traceability efforts in the Great Lakes region and beyond is necessary

It is vital to boost the demand for conflict-free minerals from the Great Lakes region and to overcome remaining problems regarding the implementation of conflict-free certification in the DRC. There is still hardly any general infrastructure to trace artisanally mined minerals from mine to export, e.g. the trading centres in-between mines and export that are meant to be building blocks for a conflict-freee supply chain

in-country are too few in number. There are continued reports that conflict minerals are mixed with certified minerals (both in the DRC and Rwanda). Legal uncertainty surrounds artisanal mining in eastern Congo because most mining areas are covered by industrial mining concessions handed out during and after the two Congo Wars, often under dubious circumstances. The Congolese state sets the legal requirements for artisanal miners very high—e.g. miners have to be registered as co-operatives—and at the same time hardly provides for artisanal mining zones, the only places where artisanal mining can be exercised in full respect of the law. As conflict-free minerals initiatives make legality a precondition, the entirety of the artisanal mining sector has been punished. In addition, political structures in the DRC and other conflict-affected and high-risk areas work much more along the principles of informal politics (what Congolese call l*a débrouille*) than principles of the rule of state law. Some high-ranking officials have links to established smuggling networks.

Despite these hurdles, the transnational efforts of mapping, tracing and certification to eliminate the links of the Congolese artisanal mining sector to conflict financing and the worst forms of abuse have created a considerable momentum among Congolese and international stakeholders. The European Union should work to keep up this momentum by putting weight behind the "accompanying measures" mentioned in the EU Communication, instead of giving in to the difficulties. Relevant action includes support for multi-stakeholder monitoring and tracing initiatives and targeted support to artisanal miners through local civil society organisations. For companies it is important to note that due diligence should be seen as an ongoing process, the aim of which is to monitor the local situation as closely as possible and to take mitigating action where necessary.

Box 1
Artisanal minining in eastern DRC

In eastern DRC, artisanal mining is the most important coping mechanism and survival strategy for about one million people, as there are few alternative livelihood options. The local economy depends to a large extent on the income and expenditure of miners.
With the drastic decline in local prices for tin, tantalum and tungsten following the exit of many companies from the DRC after 2010, the large majority of artisanal miners have moved to the gold sector. Its small size and high value render gold easy to smuggle and attractive to armed groups and bandits, which is why intermediate traders tend to fear for their security when using official, more visible channels. Involvement by non-state armed groups or the Congolese army was reported for over 500 cases out of 1088 surveyed mining sites by the end of 2014. Out of these, the army was involved in 313 mining sites.

Source: IPIS (2014). Analysis of the interactive map of artisanal mining areas in eastern DR Congo: May 2014 update: http://www.ipisresearch.be/download.php?id=452

Overcoming the *de facto* embargo by mandatory due diligence requirements for EU companies

The situation of a *de facto* embargo (or "trade distortions"), caused by global smelters and refiners ceasing to purchase minerals from eastern DRC, can only be overcome if, first, all efforts are geared to boosting the demand for conflict-free minerals from the Great Lakes region and, second, the supply of such minerals is increased to meet the demand.

EU legislation can only be effective in that sense, if due diligence requirements for EU companies are mandatory and encompass a greater section of the downstream part of the supply chain. Due diligence requirements could be extended to companies listed on EU stock exchanges—approximately 1,000 out of the 7,959 EU-listed companies. At a minimum, due diligence on conflict minerals could be included under the reporting requirements of the existing EU Directive on non-financial reporting (Directive 2014/95/EU), which applies to large companies.

EU Member States have already endorsed the voluntary OECD Guidance on which the EU legislation in question is based. Current due diligence practices by companies and the limited number of European importers of minerals and metals performing it suggest that the proposed voluntary importer requirements will only lead to a marginal increase in the demand for conflict-free minerals. In this regard, the planned

list of certified European importers can help manufacturers of semi-finished or final products to conduct supply chain due diligence. However, only if European companies further downstream are required to conduct due diligence will refiners and other suppliers outside of Europe feel a substantial increase in demand for conflict-free guarantees, which will increase the bargaining position of individual European companies seeking information from them.

Mandatory requirements cannot scare European companies away from buying minerals from the DRC because they don't source directly from the country but rely on smelters most of which have already withdrawn from the region. Now, they can exert leverage through smelters in their supply chain to source conflict-free minerals. Sourcing conflict-free minerals from the Great Lakes region can be cost-effective for companies, as costs for conducting supply chain due diligence are manageable, and prices for minerals from conflict regions are generally 30 to 40% below world market average.

The successful return of smelters to the region will in turn depend on the success of mapping and tracing initiatives on the ground. Consequently, there needs to be continued and increased support by EU actors for local mapping and traceability efforts, as political structures in conflict-affected and high-risk areas tend to render the implementation of such initiatives difficult. The minerals targeted by the legislation are not the only source of income for armed actors, and armed actors as well as artisanal miners can adapt quickly to changing market patterns. Therefore, European legislation should leave room to include a wider range of natural resources produced in conflict-affected and high-risk areas.

Outlook

A paradigm shift is needed with regard to the regulation of artisanal mining in the DRC and elsewhere: An approach that enables rather than prohibits artisanal mining is better suited to facilitating registration and market access of informal artisanal miners who do not have links to armed groups or the military. Such an approach builds on the formalisation of existing practices and aims at working with miners to improve their compliance with the law, instead of prohibiting their activities. It includes technical support for artisanal miners to improve working conditions, to limit environmental damages they cause and to find alternative income opportunities. This will make the identification of problematic practices much easier than if an entire sector is driven underground. It is also better suited to address the informal politics of regulating the mining sector typical of many conflict-affected and high-risk areas.

Finally, efforts to regulate the mineral trade must be part of a broader peacebuilding agenda, for they alone cannot end resource-related armed conflicts. Such an agenda needs to address root causes and other factors beyond the mineral sector that motivate people to continue fighting. Where mining provides for the majority of livelihood options, basic livelihood necessities of people living in conflict regions need to be prioritised and weighed against the objective of containing armed groups, because the sudden loss of income opportunities provides the ground for conflict motives.

FURTHER READING

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