ALLEN & OVERY

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Conflict Minerals

THE EUROPEAN DRIVE FOR GREATER SUPPLY-CHAIN TRANSPARENCY CONTINUES

The push for greater supply-chain transparency for businesses operating in Europe took another step forward in May this year. New European rules were finally adopted on carrying out supply-chain due diligence on so-called conflict minerals destined for Europe.

EU Regulation 2017/821 (the **Regulation**) establishes a Europe-wide framework for supply-chain due diligence for EU-based importers of certain minerals and metals originating in conflict-affected and high-risk areas.

The key requirements of the Regulation come into force on 1 January 2021 and will apply directly across all EU Member States. They will oblige importers, smelters and refiners of (a) ores and concentrates containing tin, tantalum and tungsten, (b) gold and (c) metals containing or consisting of 3TG[1] to carry out mandatory due diligence checks on suppliers when annual import volumes exceed certain thresholds.[2]

The main obligations fall on importers and/or traders of 3TG into Europe, together with refiners and smelters. There will, however, be indirect effects on those in the 3TG supply chain.

The new rules are aimed at ensuring that trade into the EU of 3TG does not fund conflicts and human rights abuses in conflict-affected and high-risk areas such as the Democratic Republic of Congo (**DRC**) and the wider African Great Lakes region.

Whilst businesses have time to prepare for the new requirements, the obligations are potentially far reaching and raise difficult questions about the extent of supply-chain diligence which will need to be carried out. The regime must also be seen in a wider context. A range of initiatives has been introduced over the past three years requiring (whether directly or indirectly) EU business to look more closely at its supply chains. There is clearly a sense amongst European policy makers that business needs to do more to assess and manage supply-chain risks. This shift in focus shows no sign of abating.

The Regulation bears some similarities to the conflict minerals provisions of the United States' Dodd-Frank Act.[3] Those provisions require companies to undertake due diligence and disclose the use of minerals imported from the DRC and certain neighbouring countries. The EU regime will, however, have a wider geographical reach than the Dodd-Frank Act.

Are you an importer?

The main obligations fall on so-called 'Union importers', ie those who declare minerals or metals for release for free circulation into the EU (or on whose behalf such a declaration is made). There is no stipulation in the Regulation that these persons need to be established in the EU.

In the early stages of the draft legislation, the obligations were intended to apply to all actors in the supply chain, including downstream businesses that manufacture products using 3TG; however, this point was dropped during the trialogue negotiations. As a result, the Regulation does not impose a diligence obligation on downstream users of 3TG unless they also happen to be direct importers of 3TG into the EU.

What about smelters and refiners?

Smelters and refiners are those persons carrying out any form of extractive metallurgy involving processing steps with the aim of producing a metal from a mineral. There is no requirement for them to be established in the EU.

Which metals and minerals are caught?

A prescribed list of minerals and metals, with their associated CN codes, are caught (as set out in Annex I of the Regulation). These are commonly referred to as '3TG', being (a) the ores and concentrates of tin, tantalum or tungsten, (b) gold and (c) metals containing or consisting of tin, tantalum, tungsten or gold.

You will also need to assess your import volumes, as certain quantity thresholds will apply for each mineral and metal to be caught.

The obligations do not apply to stocks created prior to 1 February 2013.

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1 3TG means, in summary, tin, tantalum, tungsten and gold.

2 The list of minerals and metals, set out in Annex I to the Regulation, includes for example: Tin ores and concentrates; Tungsten ores and concentrates; Tantalum or niobium ores and concentrates, Gold ores and concentrates; Gold, unwrought or in semi-manufactured forms, or in powder with a gold concentration lower than 99.5 % that has not passed the refining stage; Tungstates; and Tantalates.

3 Removal of the conflict minerals provisions of the Dodd-Frank forms part of a reform bill that passed the U.S. House of Representatives in June 2017. The bill stills need to pass through the U.S. Senate. Separately, the U.S. Securities and Exchange Commission, as the regulatory body, had pulled back previously from enforcing these provisions.

WHAT ARE THE KEY OBLIGATIONS?

Importers of 3TG minerals and/or metals are required to take a number of steps, including:

(a) adopting (and communicating to suppliers and the public) their supply-chain policy for minerals and metals potentially originating from conflict-affected and high-risk areas (and communicating the same to suppliers and the public);

(b) adopting (as part of their supply-chain policies) due diligence standards which are consistent with those standards set out in the model supply-chain policy in Annex II to the OECD's Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (Second Edition, OECD 2013) (the **OECD Guidance**);

(c) making sure that responsibility for supply-chain due diligence has been given to an appropriate member of senior management in order to oversee the diligence process and maintain necessary records;

(d) incorporating appropriate provisions into their supply contracts; and

(e) establishing a grievance mechanism for stakeholders which could include recourse to an external expert such as an industry ombudsman.

There are separate and distinct requirements for a chain of custody/supply-chain traceability system.

Minerals importers must operate a chain of custody or traceability system that provides information such as the description of the mineral, the name and address of the supplier to the EU importer and the country of origin. Where the minerals originate from conflict-affected and high-risk areas or other supply-chain risks are present, additional information must be provided, such as the mine of origin; the locations where the minerals were consolidated, traded and processed; and taxes, fees and royalties paid.

Similar (but not identical) obligations apply as to traceability for metals, with more focus on the smelters and refiners in the supply chain.

Importers of by-products are required to provide information from the point of origin of those products ie the point at which the by-product is separated from its primary mineral or metal falling outside the scope of the regime.

The traceability requirements do not apply to metals derived only from recycled or scrap sources. However, the importer must disclose (and set out in reasonable detail) the supply-chain due diligence measures it exercised in determining that the metals were derived only from these sources.

Many of the key obligations in the Regulation follow the OECD Guidance. The Guidance requires an importer to follow a five-step framework, which is reflected in Articles 4-7 of the Regulation.[4]

[4] These five steps are: establish strong company management systems; identify and assess risk in the supply chain; design and implement a strategy to respond to identified risks; carry out independent third-party audit of supply-chain due diligence at identified points in the supply chain; and report on supply-chain due diligence.

ASSESSING YOUR SUPPLY-CHAIN RISKS

Importers of minerals are required to identify and assess the risk of adverse impacts in their mineral supply chains against the standards set out in their supply-chain policy. They are also required to implement a strategy to respond to, and address, any risks. This can include internal reporting to the appropriate members of the senior management and taking steps to "*exert pressure on suppliers who can effectively prevent and/or mitigate the identified risk*". Any such pressure could include the possibility of suspending trade while the risk mitigation efforts are undertaken, or disengaging with the supplier after any failed attempts at risk mitigation.

If the importer of minerals pursues risk mitigation efforts while continuing trade or temporarily suspending trade, it is required to consult with the suppliers and stakeholders concerned (which could include local and central government or several society organisations) and agree on a strategy of risk mitigation, such as progressive performance improvement.

A similar, but slightly different, approach is taken in respect of importers of metals to reflect the different supply-chain structures. These importers are required to identify and assess, in accordance with the OECD Guidance, their supply-chain risks based on available third-party audit reports on the smelters and the refiners in the relevant supply chain. They should also be assessing, as appropriate, the due diligence practices of those smelters and the refiners. If there are no third-party audit reports, importers may be required to carry out their own audits in accordance with the requirements of the regulations.

The Regulation does not stipulate how far up the supply chain importers are expected to go; however, it defines supply-chain due diligence as requiring importers "*to prevent or mitigate adverse impacts associated with their sourcing activities*". This includes "*risk management, independent third-party audits and disclosure of information with a view to identifying and addressing actual and potential risks linked to conflict-affected and high-risk areas*".

AUDIT OBLIGATIONS

Importers are required to commission third-party audits of their supply chains. Audits should include a full review of the importer's activities, due diligence and risk management systems. The audit must make recommendations as to how the importer can improve its supply-chain due diligence practices.

Importers of metals may be exempt from this requirement where they can demonstrate that all smelters and refiners in their supply chains comply with the regime.

DISCLOSURE OBLIGATIONS

The new regime also imposes potentially far-reaching disclosure obligations. Importers are required to make available to Member State authorities any third-party audit reports carried out, or evidence of conformity, with a due diligence scheme recognised by the European Commission (see below).

In addition, importers of minerals or metals are required to make available to their immediate downstream purchasers all information gained and maintained pursuant to their supply-chain due diligence (although there is recognition of business confidentiality and antitrust concerns).

On an annual basis, the importers are also required to publically report "*as widely as possible*" on their supply-chain due diligence policies and practices for responsible sourcing.

Further, according to guidance published by the European Commission on 26 June 2017, companies which are required to publish non-financial information under the Non-Financial Reporting Directive (**NFRD**) should include in their disclosure detail on their approach to diligence on conflict minerals. While the guidance is non-binding, the Commission has stated that it expects companies that are in the scope of the NFRD to disclose relevant information on the performance of their policies and practices related to conflict minerals due diligence, notably by using performance indicators. Disclosures should be consistent with the OECD Guidance.

DUE DILIGENCE SCHEMES

One of the challenges for importers will be deciding how extensive their due diligence should be and the extent to which a risk-based approach can be adopted. In order to ensure a level of consistency, the regime allows for interested organisations (including industry associations) to have supply-chain due diligence schemes formally recognised by the Commission.

The implementation of such a scheme should give operators significant comfort that they are complying with the key requirements of the regime. Although it is not a legal guarantee of full compliance, it may also reduce significant variations in approach between operators. That said, the Commission can withdraw its approval of a due diligence scheme at any time.

Impact of Brexit

There remains considerable uncertainty over the future relationship between the UK and EU-27 following Brexit. In general, the UK Government intends to adopt EU law in place on 28 March 2019 as UK law, as set out in the Government's White Paper of 2 February 2017. In the context of conflict minerals, this raises a number of immediate considerations, including:

(a) in theory, the new requirements would apply to importers into the UK in essentially the same way as if they were importing into the EU for the first time;

(b) exporters (or re-exporters) from the UK to the EU would be treated in the same way as an exporter from a third (ie non-EU) country. This would impose additional burdens on businesses exporting from the UK to the rest of the EU as compared to the pre-Brexit position. For instance, an importer who currently uses the UK as the first entry point for minerals/metals into the EU would then potentially have additional burdens when re-exporting products from the UK to the EU-27. In practice, this may only prove to be material when there is a divergence in approach between the UK and EU on how the regime should apply; and

(c) depending upon the precise terms of the UK's trading relationship with the EU-27 immediately after Brexit, the import of minerals and metals into the UK may be governed by WTO trading terms, and tariffs may apply to exports into the UK and re-exports from the UK into the EU. Unless the UK and EU agree a new customs arrangement by March 2019, the UK will have its own customs procedures and any re-export of metals and minerals from the UK to the EU will potentially be subject to separate (and additional) administrative burdens.

What should you be doing now?

Given that the new requirements do not take effect until 2021, you have time to assess the impacts and the steps required to comply. In particular, you should:

- assess whether you are established as an importer, smelter or refiner;
- map your existing supply chains to determine where gaps in your sourcing information may exist;
- review your existing supply-chain policies (if any) and supplier codes of conduct (etc), and develop a gap analysis against the new requirements (including the OECD Guidance);
- conduct an initial review of your suppliers to identify where issues may exist in light of the new regime;
- review your purchase contracts to determine the extent to which changes will need to be made;
- review the extent to which existing industry-wide standards and procedures are appropriate or whether, and how, any new sector initiatives need to be developed;[5] and
- assess the impact of Brexit on your supply and import arrangements, and model the worst and best case positions as the negotiations evolve.

[5] Existing initiatives include the Alliance for Responsible Mining and the London Bullion Market Association Responsible Gold Guidance.

Key contacts

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