

Impact of "Conflict Minerals" on Regulatory Compliance



Background

Concern was raised some years ago in the USA regarding the ethics of using materials sourced from the Democratic Republic of the Congo (DRC) in the USA, particularly in the electronics manufacturing sector. The reason behind the concern was that the sale of this material by armed militias was funding the civil war in the region, leading to exploitation of and the use of violence against the local population. In April 2009, a Congo Conflict Minerals Act was introduced in the USA, to require electronics companies to verify and disclose their sources, but this legislation died in committee.

In the aftermath of the Enron and other financial scandals in the USA, a major amendment to the Securities Exchange act of 1934 was formulated. This new law, the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, was passed by the US Senate on 20 May 2010 before being signed into law by President Barack Obama on 21 July 2010. Section 1502, generally referred to as the "Conflict Minerals Law", requires US companies to disclose the source of certain minerals in their product. The original 1934 act has been amended to include this text.

This document seeks to summarise the situation and the impact on industry.

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DRC is in central southern Africa, and was formerly known as the Belgian Congo and later Zaire. There is a short seaboard on the Atlantic Ocean at the mouth of the Congo River, with the port of Matadi, there is no direct outlet to the Indian Ocean. The surrounding countries are Angola, Zambia, Tanzania, Rwanda, Burundi, Sudan, the Central African Republic (CAR) and Republic of Congo (a separate nation to the DRC).

Requirements

USA

The main intent of the Dodd-Frank Act is to reduce the use of so-called "conflict minerals" from DRC and associated sources through a regime of public reporting and scrutiny which pressurise producers to take proper responsibility for their supply chains. The main outcome of this initiative will be an increased knowledge of the supply chain, and knowledge of where materials originate. Similar approaches have been successful in other industry sectors particularly forestry, diamonds (The Kimberley Process) and clothing.



The Securities and Exchange Commission (SEC) has defined "conflict minerals" as:

(A) columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives; 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.

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The table below shows the source and some of the more commonplace uses for these materials, together with an approximation of the proportion of the mineral arising from the DRC.

Ore • Element	Examples of uses	Sources and comments	Approx % world supply from DRC (2007)
Cassiterite • Tin	Solders, solderable coatings, corrosion resistant coatings, bronze alloys, glass additive, flame retardants, biocides	Many other sources outside this geography. Major Source (2007) : P R China : 43%	1%
Wolframite • Tungsten	High temperature applications (lamp and electron microscope filaments, engines, lubricants, welding, photomultiplier tubes), hard alloys (e.g. turbine blades), tungsten carbide drill bits etc., munitions, radiation shielding, metal coatings on ceramics and on silicon ICs.	Many other sources outside this geography. Major Source (2007) : P R China 85.9%	<1% 13% Rwanda*
Comubite-Tantalite (Coltan) • Tantalum	Tantalum capacitors, high refractive index glass, power resistors, high temperature alloys, corrosion resistance.	Few alternative sources outside this geography. Major Source (2007) : Australia 60.7%	9% DRC* 9% Rwanda*
• Niobium	Niobium alloys including steels, superconducting alloy with titanium or tin is used in MRI and other instruments with superconducting magnets. Pacemakers, sodium lamps and arc welding.	Major Source (2007) : Brazil 53.4%	
Various • Gold	IC wire bonding, plating, electric contacts and connectors.	Many other sources outside this geography. Major Source (2007) : South Africa 10.8%	< 1%
Colbaltite etc. • Cobalt	Lithium NiCd and NiNH batteries, hard and corrosion resistant plating, moisture indicators, special alloys (e.g. turbine blades), Alnico magnets.	Not explicitly named but is likely to qualify as an "other mineral". Major Source (2007) : DRC	~ 35% ~ 41% *

Source : USGS unless marked with * in which case EU Communication COM(2011) 25 final, 2 Feb 2011 for 2008/9.

Many of these types of electronic components come from China and one source of these raw materials will inevitably be the DRC. Nickel and copper are also mined in the DRC so could be added to the list.

Detailed compliance standards and expectations of the SEC are expected to be published during Q4 2011, with the first reporting period being for the fiscal year ending Q4 2012.

The essential requirement of the Dodd-Frank Act, Clause 1502 is to require any organisation placing products on the market in the US to

declare whether "conflict minerals", originating from the DRC and adjoining countries are present. Thus companies that use the defined materials need to be able to show their origins; and as the national borders are somewhat leaky, the Act requires import from adjacent countries as well as the DRC to be recorded. For example, it is thought that Rwanda exports about 5 times the amount of tin than is actually mined in that country, which may not be immediately apparent from information received up the supply chain.

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A company trading in the USA will be affected by this Act if :

- (a) It files reports with the SEC under the Securities and Exchange Act of 1934
- (b) Its use of the minerals is “necessary to the functionality or production” of the products.

The requirements are applicable to any organisation (or person), called an “issuer”, using “conflict minerals” in their products based in the US whatever the size. This could include parties who:

- Are the brand owner of a product.
- Contract to have the product manufactured specifically for themselves.
- Have influence over the “product’s manufacturing”.

This would therefore include parties who have design authority over a product or buy in large volume which is often the case for large retailers and distributors for example.

Thus in order to comply a company will need a detailed and extensive knowledge of its supply chain. It would be prudent for any company having a legal entity in the US to conduct and document a “due diligence” exercise of their supply chain with regard to the origins of any of the materials specified in Section 1502.

The SEC will also be looking for evidence of an independent 3rd Party audit of the process and results.

This declaration would be on an annual basis both to the SEC and on the company’s public web site. Where “conflict minerals” might be used they must also report to the SEC the steps they are taking to identify the source and eradicate them.

Inclusion in the annual report to the SEC applies where “conflict materials” may be present and is based on a “reasonable country of origin inquiry”. It is not stated what is reasonable but clearly the process used to define this for all products should be documented by any party to whom this Act may apply.

Where “Conflict Minerals” did not originate in DRC countries	Where it cannot be shown that “Conflict Minerals” did not originate in DRC countries
Disclose the determination that “Conflict Minerals” did not originate in DRC countries.	Disclose this conclusion and Note that the “Conflict Minerals” Report is furnished as an exhibit (e.g. annex) to the annual report.
Disclose the “reasonable country of origin inquiry” process used in reaching this determination.	Provide a “Conflict Minerals” Report.
Make the disclosure regarding this determination available on its Internet website.	Make available the “Conflict Minerals” Report on its Internet website and disclose this fact.
Provide the Internet address of that site.	Provide the Internet address of that site.
Maintain records demonstrating that its “conflict minerals” did not originate in the DRC countries	Documentation beyond the “Conflict Minerals” Report is not stated as required but clearly would be prudent.

The “conflict minerals” report would be required to provide evidence of the due diligence measures taken and detailed information on the supply chain such as the facilities used to process the “conflict minerals” and efforts taken to locate the source. Showing the material to be sourced from scrap or recycled materials is one way of showing its origin. The report would be subject to audit by an independent third party according to a defined standard, which has yet to be elaborated.



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Europe

While there are currently no legal requirements covering the use of “conflict minerals” within the EU, this has been a matter of scrutiny within the Commission and Parliament for many years. Recently the UK Chancellor of the Exchequer and Business Secretary raised this at the G20 Finance Minister’s Meeting early in 2011, and are pushing for European legislation mirroring the requirements of the Dodd-Frank Act in the USA. As yet we have not seen any legislative proposals tabled however.



Implications and next steps for industry

While the Dodd-Frank act applies only to publicly traded companies in the US, it will of necessity impact their supply chains as they seek better information on “conflict minerals” from their suppliers. It is also very likely to add to pressure on companies formally outside of scope to up their game both from customers and lobby groups. Companies will be asked serious questions by their customers and other parties, and as such they should develop and implement a plan to address “conflict minerals” as a matter of some urgency.

The requirements for meeting “conflict mineral” obligations are very similar to those of meeting the EU RoHS Directive or the REACH Regulation, in that in the event of enforcement action, an audit trail is necessary to be able to demonstrate to the authorities that a process of Due Diligence has been followed. A robust approach to showing due diligence often makes reference to and uses best practice.

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OECD Guidance (Organisation for Economic Co-operation and Development)

The OECD has published guidance on responsible supply chain management⁶. The guidance was developed as a collaborative project involving the countries where “conflict minerals” arise, industry and the UN⁷, therefore it carries significant credibility. The guidance advocates a five step approach to due diligence:

1. Establish strong company management systems.
2. Identify and assess risk in the supply chain.
3. Design and implement a strategy to respond to identified risks.
4. Carry out independent third-party audit of supply chain due diligence at identified points in the supply chain.
5. Report on supply chain due diligence.

Options for industry

Industry has a number of options available in addressing the “conflict minerals” problem:

Do nothing

This approach is essentially untenable for a major supplier of products which, in general worldwide, may make use of “conflict minerals”. Companies will come under increasing pressure to respond from its customers and investors.

Go it alone

Industry to request information on “conflict mineral” compliance from its suppliers: This is a very difficult process and the response and quality of response is frequently low even for relatively straightforward requirements like RoHS. The response for “conflict minerals” is likely to be even poorer. Companies should also incorporate “conflict minerals” in supply chain audits.

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Gathering Essential Information



As gaining information from the upstream supply chain is likely to be long and somewhat convoluted, this activity should be started as soon as is practicable.

Companies should initiate a query of suppliers about the presence or otherwise of the “conflict minerals” in their product, and their country of origin; perhaps adapting the EICC supply chain tool for this purpose.

1. Modify your product database to allow the recording of key data:
 - a. The request to the supplier; date sent, person sent to, etc
 - b. A number of follow up contacts made, with dates and responses
 - c. The response from the supplier (date received, how it was validated, follow-up actions)
 - d. Which “conflict minerals” may be present in the product, and in what proportion
 - e. The country of origin of the “conflict minerals” and any additional pertinent details on the source.
 - f. Steps being taken by the supplier to reduce the risk of “conflict minerals” being present.

2. As is the case with RoHS compliance, any supplier documentation should be signed off by a senior member of their management team.
3. The OECD guidance recommends retaining documentary evidence for a minimum period of 5 years.

With thanks to Andy Skarstein, ERA Technology.



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