Rule of Law

The new Conflict Minerals Rule affects mining and metals companies across the world

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On August 22, 2012, the US Securities and Exchange Commission (SEC) adopted what is commonly referred to as the Conflict Minerals Rule. The rule requires US public companies to determine whether tin, tantalum, tungsten or gold – the 3TG – are contained in the products that the company manufactures or contracts to manufacture and, if 3TG is contained in the products, whether it is necessary to their functionality or production.

If so, the company must take steps to determine and make specified disclosures concerning, among other things, the source of the 3TG contained in its in-scope products.

Heightened due diligence and reporting is required to the extent that the 3TG originated in the Democratic Republic of the Congo (DRC) or one of its nine adjoining countries.

The rule is intended to reduce a significant source of funding for armed groups that are committing human rights abuses, particularly in the eastern DRC.

Who is subject to the rule?

The rule potentially applies to all companies that are public in the US, including foreign issuers. Private companies are not directly subject to the rule, since they are not SEC reporting companies.

However, they are indirectly affected by the rule to the extent that they are part of a public company's supply chain and will need to follow many of the same compliance procedures as public companies. More than 280,000 private companies are conservatively estimated to be part of the US public company supply chain.

Although many mining companies are public in the US, they generally do not have reporting obligations under the rule, since the SEC does not view mining as being equivalent to manufacturing.

Other activities commonly associated with mining, such as transporting, crushing and milling ore, also do not come within the scope of the rule.

However, even if they do not fall within the scope of the rule, like many other companies, businesses in the mining and metals industry are generally part of the public company supply chain.

As a result, they will also need to be sensitive to market dynamics relating to 'conflict free' sourcing and will need to follow many of the same compliance procedures as public companies that are subject to the rule.

What does the rule require?
The rule requires public companies to conduct up to a three-step inquiry. Step one of the inquiry requires companies to determine whether 3TG is contained in products that are manufactured or contracted to be manufactured by the company and, if so, whether the 3TG is necessary to the functionality or production of the products.

Step two requires a company to conduct a "reasonable country of origin inquiry", or RCOI, to determine whether its in-scope 3TG content originated in the DRC or one of the other covered countries or is from recycled or scrap sources.

Recycled and scrap 3TG is treated somewhat differently under the rule since a company will not be able to trace its origin back as far as newly mined minerals.

3TG is considered to be from recycled or scrap sources if it is from recycled metals, which are reclaimed end-user or post-consumer products, or scrap processed metals created during product manufacturing.

Recycled metal includes excess, obsolete, defective and scrap-metal materials that contain refined or processed metals that are appropriate to recycle in the production of 3TG. Minerals that are partially processed, unprocessed or a by-product from another ore, are not considered to be recycled.

The rule does not contain a bright-line test for conducting the RCOI. What constitutes a reasonable inquiry for a particular company will depend upon various factors, such as the company's size, its products and its relationship with suppliers and supply chain visibility at the time.

The RCOI may be satisfied by obtaining reasonably reliable representations indicating the facility at which the 3TG was processed and demonstrating that it did not originate in a covered country or that it came from recycled or scrap sources.

These representations can come directly from the processing facility or from intermediate suppliers, but the company must have a reason to believe that the representations are true and correct given the circumstances surrounding them.

A company can stop at step two of the inquiry with respect to particular products or 3TG content in the event of the following:

- it determines that the 3TG originated outside of the covered countries or came from recycled or scrap sources; or,

- based on its RCOI, it has no reason to believe that the 3TG may have originated in a covered country or it reasonably believes that the 3TG is from recycled or scrap sources.

However, the company must file a Form SD – a new SEC form – that discloses its determination and briefly describes its RCOI.

The rule requires Step 3 due diligence to be conducted in conformance with a nationally or internationally recognised due diligence framework.

At the present time, the only framework that satisfies this requirement is the Organisation for Economic Co-operation and Development's (OECD's) Due Diligence Guidance for Responsible Supply Chains of Minerals From Conflict-Affected and High-Risk Areas. There are two supplements to the OECD guidance: one covers the 3Ts and the other covers gold.

In most cases, a company that is required to conduct step three due diligence must prepare a Conflict Minerals Report (CMR). Among other things, the CMR must describe the measures that the company took to exercise due diligence on the source and chain of custody of the applicable conflict minerals.

The CMR must contain a description of any of the company's products that have not been found to be "DRC conflict-free". It must also indicate, to the extent known, the facilities used to process the 3TG and their country of origin and the efforts used to determine the mine or location of origin with the greatest possible specificity.

SEC reporting companies with in-scope products are required to file their first Form SD no later than May 31, 2014. The report must cover the 2013 calendar year.

Thereafter, affected public companies must file a Form SD annually by May 31 of each year, covering the most recently completed calendar year. Although some public companies have already begun to solicit information from their supply chains, these efforts will intensify during 2013's December quarter.

Controversy and legal challenge

The rule has proved highly controversial. Although there is strong support among public companies for the policy goals behind the rule, it has been severely criticised because of its significant compliance costs. There are also divergent views as to whether the rule is doing more harm than good by creating a de facto embargo on the sourcing of 3TG from the central African region.

Not surprising given the controversy surrounding the rule, it has been challenged in court. Last October, a legal challenge seeking to overturn the rule was brought by the National Association of Manufacturers, the US Chamber of Commerce and the Business Roundtable (an association of chief executives from leading US companies).

In late July, the US District Court for the District of Columbia rendered its decision, rejecting all of the plaintiffs' claims. The plaintiffs have appealed the decision.

Under the schedule set by the Court of Appeals, there will not be a decision from the court until sometime in 2014. Pending the outcome of the appeal, the rule continues in effect as adopted.

Where are we now?

Even if the rule ultimately is set aside by the court, given the nature and amount of work required to meet the May 31, 2014, filing deadline or comply with customer requirements on a timely basis, public companies, and their suppliers, will need to complete a substantial portion of their work before the court reaches its decision.

They will not have the luxury of waiting until the court renders a decision to ramp up their compliance efforts. Many companies in the mining and metals industry have already been implementing compliance programmes in response to the rule, either directly or through trade associations and other multi-stakeholder initiatives.

However, for those that have opted for the wait-and-see approach, now is the time to begin their compliance efforts in earnest.