The US "Conflict Minerals" Legislation (s.1502 of the Dodd-Frank Act): Rhetoric v Reality

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Contents

1. Background of Presenter

- Newly-appointed MD of Rainbow Rare Earths Limited, which owns the Gakara REE Project in Burnundi – 54.3% TREO deposit, the highest grade REE project in the world; to produce 5,000tpa TREO in concentrate (65-70%)
- Co-founder and MD/Chair of Globe Metals & Mining (ASX:GBE), which raised a total of A$80m+ and developed the Kanyika Niobium Project in Malawi from a grassroots discovery to a well-funded feasibility with an Asian strategic partner
- Co-founder of DMC Mining (ASX:DMC): Fe in ROC and Volta Mining (ASX:VTM): Fe in Gabon
- Chairman of Casserley Mining Limited: Sn/Ta in Katanga, DRC
- Bachelor of Laws (UWA, Hons); MBA (Lon); member of the Securities Institute of Australia.

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Part A: What the Conflict Minerals Legislation is Designed to do (Rhetoric)

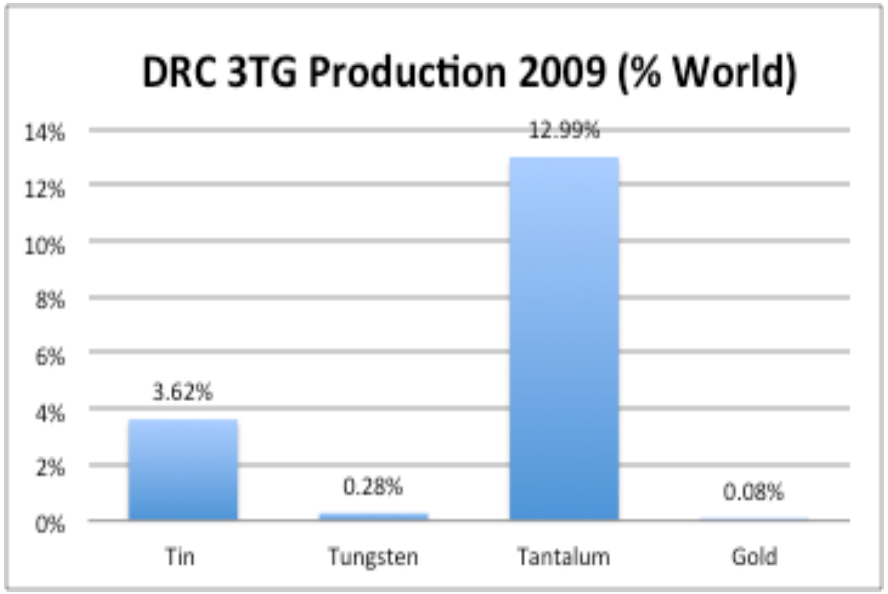
2. Conflict Minerals Legislation: Policy Setting

- The Conflict Minerals legislation is contained in s.1502 of the US Financial Stability Act, otherwise known as the Dodd-Frank Act, signed into law in July 2010, in the aftermath of the GFC
- To some extent the legislation in its totality was a response to populist demand for greater scrutiny and regulation of the US banking sector
- S.1502 is anomalous in the context of the overall Act, but consistent in so far as it has the effect of imposing additional compliance on US industry (although not the banking sector, being the primary focus of the Act)
- The Conflict Minerals legislation is a well-intentioned policy response to the ongoing eastern Congolese conflict, with its aggravated incidence of sexual and gender-based violence; championed by the then US Secretary of State, Hilary Rodham-Clinton
- The purpose of the Conflict Minerals legislation is to break the nexus between, on the one hand, the mineral proceeds controlled by rebel/non-government troops, and on the other hand, the activities of the rebel groups which "is characterized by extreme levels of violence particularly sexual and gender-based violence ".
- At the height of the war, there were reports of up to 2,000 violent rapes per month
- Mirror legislation being considered by the EU and Canada.

3. Conflict Minerals Legislation: Operation Overview

- "Conflict Minerals" (CM) are minerals deemed to be financing conflict in the DRC or an adjoining country
- "Cassiterite, columbite-tantalite, gold, wolframite, or their derivatives, or any other mineral or their derivatives determined by the Secretary of State to be financing conflict in a Covered Country" – i.e. "3TG": tin, tantalum, tungsten and gold
- A "Covered Country" is any of DRC and its adjoining neighbors, Angola, Burundi, Central African Republic, Republic of Congo, Rwanda, Sudan, Tanzania, Uganda and Zambia
- Legislation applies to a US publicly traded company, subject to regulation by the SEC, including certain foreign companies listed on US exchanges
- Regulated companies that manufacture products containing 3TG are required to show that the 3TG does not originate from a Covered Country, or if it does, that it is "conflict free" – its production did not directly or indirectly finance or benefit armed groups in the Covered Country.
- In essence, to keep CM out of the supply chain – so even if not a manufacturer, other businesses involved such as suppliers and distributors will be drawn into the compliance regime
- The 3TG in the product must be "necessary to functionality"; not applicable to verified scrap or recycled sources, or by-products.

4. DRC: Production of 3TG



Source: http://venkel.com/compliance/infographics/conflict-minerals-infographic#.UYpqUIA3ZLE.email.

5. The Eastern Congolese Conflict

- Residue of the '94-95 Rwandan ethnic conflict, and the large number of displaced (former?) Rwandans that remain in the eastern DRC, although unique in its genesis
- Nature of the conflict is forever fungible and evolving, with proximate causes including security risks, international boundaries disputes, ethnic rivalries, competing land uses, access to minerals, sponsored/proxy contests and institutionalised vested interests in the conflict continuing
- Conflict centered around North and South Kivu – at present, rebels control Ruthsuru district and parts of Masisi district in North Kivu, and there is ad hoc rebel-related activity in South Kivu and northern Katanga
- Population and sqkm of North and South Kivu combined is 10.4m and 125,000sqkm; DRC: 65.3m and 2.35m sqkm; Covered Countries (incl. DRC): 217m and 7.19m sqkm

Source for population and land area: Wikilpedia

6. Conflict Minerals Legislation: Compliance Regime

- SEC directed to develop regulations by April, 2011; “Final Rule” adopted in August 2012
- 3-step process:
  - 1. Determine applicability
  - 2. Conduct “reasonable country of origin inquiry” (RCOI)
  - 3. Due diligence
- Step 2 (RCOI): Issuer (regulated entity) must seek and obtain reasonably reliable representations indicating the facility at which the CM were processed, demonstrating that the CM came from either scrap/recycled sources or countries other than the Covered Countries
- Representations can come directly from the CM processor or suppliers the cascading up the supply chain
- Issuers must take into account “warning signals or other circumstances” indicating that CM may be from Covered Countries or non-scrap sources
- 100% supplier response is not required, provided the Issuer reasonably designs the inquiry, performs it in good faith and does not ignore warning signs

6. Conflict Minerals Legislation: Compliance Regime

- Step 3 (Due Diligence): if after an RCOI an Issuer knows or has reason to believe that the source of the CM is either a Covered Country or not scrap/recycled material, due diligence must be performed on the source and chain of custody
- The due diligence process must follow a nationally or internationally recognised due diligence framework – e.g. OECD's "Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High Risk Areas" (2011)
- Hence the "bag and tag" operations in DRC:
  - Tin and coltan: supported by ITRI, the tin industry member's association
  - Tungsten: the Tungsten Industry-Conflict Mineral Commitment (TI-CMC) was recently established, and is supported by tungsten industry trade associations the International Tungsten Industry Assn. (UK), and the Refractory Metals Assn. (US).
- Reports due annually, on 31 May, covering the preceding calendar year, commencing 31 May 2014
- Where due diligence is applicable, a Conflict Minerals Report (CMR) must be lodged, audited by an independent third party

„Final Rule" https://www.federalregister.gov/articles/2012/09/12/2012-21153/conflict-minerals#citation-69l Rule; Generally, see: http://prezi.com/_rahxrywggbg/elm-summary-of-secs-final-conflict-minerals-regulations/, where much of the material for this section is derived from, and is an excellent presentation

Part B: Why the Conflict Minerals Legislation is Ineffectual, Flawed or Harmful (Reality)

7. Scope of Minerals encompassed by the Legislation

- Assumption: the Legislation's scope ("cassiterite, columbite-tantalite, gold, wolframite, or their derivatives ") ought to have been (was?) designed to deny rebels access to any minerals from which they can profit in order to fund their activities. For practical purposes, this would reasonably include any economic mineral asset which can be readily and cheaply mined in North or South Kivu
- "Columbite-tantalite", or "coltan", is simplistically a family or species of minerals which have as end-members the series being (Fe, Mn) Nb_2O_6 (columbite) and (Fe, Mn) Ta_2O_6 (tantalite)
- Tantalite is easily dealt with:
  - The end-user metal, tantalum, is well-known as a critical component in consumer electronics (*"Is your mobile phone rape free?"*)
  - There are many minerals containing tantalum other than tantalite (e.g. euxenite, loparite, lueshite, tapiolite), but none that are economically mined for tantalum in the Covered Countries (note: c.27tpa of Ta_2O_5 is produced from loparite, mined from the Lovozerskoye Deposit in the Kola Peninsula of the Russian Federation, as a by-product of magnesium, REO and niobium oxide production)
  - This may not always be the case: e.g. the Kanyika Niobium Project, Malawi (not a Covered Country), contains economic quantities of tantalum, albeit as a by-product to niobium, sourced from a non-coltan/tantalite mineral, pyrochlore. It is quite possible that a similar type of deposit could be discovered in a Covered Country, especially in the Great Rift (note: there are economic pyrochlore deposits in Covered Countries, such as the Panda Niobium Deposit in Tanzania, but tantalum is not present in economic quantities)
  - Tantalum derived from pyrochlore, or anything other than coltan, is presumably not covered by the Act, as it is not "*a derivative of*" coltan. This would likely give rise to great confusion and difficulties in the supply chain audit, as well as possibly give rise to an arbitrary distinction that would require legislative remedy (or equivalent determination from the Secretary of State pursuant to s.1502).

7. Scope of Minerals encompassed by the Legislation

- Columbite is more complex, and interesting:
  - "Columbite" is a derivation of "columbium", being the element otherwise known as niobium everywhere other than in the United States
  - Prima facie, niobium, which is "*a derivative of*" columbite, would come within the umbrella of the Act. This makes sense, given that tantalum and niobium are consanguineous elements, that both are present in coltan, in ever-differing proportions, and both contribute to its concentrate value (the concentrate value is quoted in "CPO", being "combined pentoxide")
  - The main use of niobium is in high-strength low alloy steels (c.90%), doped via ferro-niobium (FeNb); the remaining c.10% is represented by high purity niobium oxides (99.5%+), metals and alloys (e.g. NiNb)
  - The vast majority of the world's niobium is produced in Brazil and Canada (pyrochlore deposits), and it is very likely the case that all of North America's FeNb consumption by steel mills is sourced from these two countries (even though the majority of the niobium extracted from coltan globally is ultimately smelted into FeNb). However, it is also very likely the case that some of North America's non-FeNb niobium consumption does or could be derived from coltan sourced from a Covered Country, and indeed conflict areas (industries that require high purity niobium oxides and metals include optical, aerospace and nuclear)
  - Nevertheless, the SEC in its "Final Rule", excluded niobium (derived from coltan) from the operation of the Legislation, and in doing so reduced the scope of the Legislation, nothwithstanding the likely presence of Covered Country (and conflict)-derived niobium in the US industrial supply chain
  - And: if there is uncertainty about the presence of such niobium in the supply chain, surely the point of the Legislation is to assuage the consumer through certification or due dilgence, as is the case with tantalum, tin, gold and tungsten? What policy interest is served by excluding niobium (or policy interest that is justifiable and consistent with the broad intent of the Legislation)?

7. Scope of Minerals encompassed by the Legislation

- Further footnote: Lueshe Niobium Mine:
  - Located in Rutshuru District of North Kivu, Lueshe is the world's second highest grade niobium deposit, and by any measure a Tier 1 or world class asset. It is the crown jewel of the Kivus.
  - The asset has never been impaired by the various surrounding conflicts and wars, and remains ready to recommence production at an annual rate of c.1000tpa pyrochlore concentrate, grading 60-65% Nb_2O_5, which with the utilisation of readily available overseas toll-treating to produce FeNb, would generate annual revenues of c.$20-25m (or c.75% of that if sold as concentrate only).
  - The Presenter has visited Lueshe; working capital of less than $1.3m is required to re-commence production (diesel, reagents, pumps, valves and back-wages). An experienced work force remains ready and willing to re-commence at short notice.
  - Being a pyrochlore deposit, it is outside the scope of the Legislation. But why is it outside of scope? This is the question.
  - Lueshe has been operated at various times over the last five years. There is no reason why it could not readily and cheaply be (re?)commandeered and brought back into operation under the auspices of a rebel force. Or at least if that were a possibility (which it most certainly is), would not it be apt for the Legislation to preclude that by somehow bringing it within scope?
- The situations with respect to the treatment of columbite and Lueshe in the Final Rule and the Legislation respectively gives rise to legitimate queries that are unanswered
- Diamonds: covered by the Kimberley Process.

8. Audit Limitations & Fraudulent Certification

- The on-ground “bagging and tagging” system is a two-stage process:
  - 1. At source verification that the product is from source, is conflict free and that the source is capable of producing at specified volumes
  - 2. Verification at the entrepot/comptoir that the product leaving the country is the same product that was verified at source
- The system is largely meritorious, but will inevitably fail and/or be circumvented:
  - The evidence from the Kimberley Process for diamonds (commenced in 2003) is that it has not had the effect of eliminating illegal actors and armed groups from the industry
  - False certifications and fake certificates are unavoidable, and are already circulating in abundance, given that 2013 is the first effective year of operation for Issuers regulated by the Legislation
  - The eastern Congolese borders are notoriously porous, and a variety of players have a vested interest in maintaining the trade in conflict minerals
  - There is a geographic limit to sites where “bagging and tagging” certification is available (self-certification?)
- The implementation of the “bagging and tagging” process is disfigured by the role of NGOs: by becoming “taggers” and generating revenue streams, a moral hazard is created

9. Compliance & Reputation Costs and Follow-On Effects

- The US National Association of Manufacturers estimates that the Legislation will apply to some c.4000 organisations, and that the initial compliance costs will be c.$3-4bn
- The result has and will be that Western operators (not only Issuers covered by the Legislation) will withdraw entirely from sourcing 3TG from not only conflict regions, but also from the Covered Countries. This is for cost and reputational reasons (e.g. H.C. Starck, Cabot Supermetals and AMC).
- All of this, including the follow-on effects, was not only forseeable, but arguably inevitable:

  "Given that the Act will effectively embargo all tantalum from the DRC and adjoining countries from use in the Western/global supply chain, it will have an indiscriminate and detrimental effect on a number of small scale and artisanal operations that are entirely legitimate, and bear no connection whatsoever with the Rwandan-Kivu wars that scar the eastern DRC. The onus of proof is too great for these miners and too troublesome for the end-users." (Mark Sumich, (then) Managing Director, Globe Metals & Mining Limited, 26 July 2010, ASX Release)

- The fallout from the grinding implementation and rollout of the Legislation will be far-reaching, and have overwhelmingly negative outcomes for the West and Africa, and overwhelmingly positive benefits for others, such as Chinese and other operators not constrained by the Legislation

9. Compliance & Reputation Costs and Follow-On Effects

- Western Supply Chains:
  - Downstream processors are being pushed out of or are withdrawing from buying not only conflict minerals, but also those sourced from Covered Countries. This is most prevalent in tantalum, where the DRC's contribution to world trade is the highest of all 3TGs
  - Western markets and governments are as a consequence either not going to have access to or pay more for some critical metals
- African Artisanal and Small Scale Miners:
  - The scope of the Legislation is not only North and South Kivu (10.4 million people), which is a relatively good proxy for potential rebel-controlled conflict areas, but all of the Covered Countries (217 million people)
  - The widespread dependence of many Africans on artisanal and small scale mining is accentuated by the lack of alternative employment. The indiscriminate impact of the Legislation on vast numbers of these people has and will be felt, and cannot be morally justified. It is unclear why the Legislation extends beyond conflict areas.
  - A good example is the experience of AMC, a London-based publicy-listed tin trader. Given the sometimes arbitrary and ever-changing zones of conflict and the intense scrutiny it was receiving from an NGO and the British parliament, it ceased all DRC operations, which impacted thousands of locals in non-conflict areas.

9. Compliance & Reputation Costs and Follow-On Effects

- Chinese and other Unconstrained Operators:
  - As inevitably as a mothe is drawn to the flame, the void left by Western operators will be filled by possibly less discerning operators
  - In December 2011, the UN cited the following Chinese operators as conflict mineral trading in the DRC: TTT Mining, Huaying Trading and Donson International (of course, not all from any country are the same)
  - The buy price for these operators will also be cheaper, given the “conflict minerals levy” that needs to be paid (by Africans) to warrant the incremental risk borne by the operators
  - Note that China is the DRC’s “strategic partner” and has a stated policy of non-interference in African “domestic” affairs
- West’s Reputation:
  - Likely to be negatively affected by the impact of the Legislation on non-conflict areas.
  - Hypocrisy/duplicity is damaging: In 2009, Zimbabwean diamonds were certified as conflict free (under the Kimberley Process), even though hundreds of artisanal miners were killed when government forces took control of the concession, based on the spurious legal distinction that since the perpetrators were government actors, and not rebels, the diamonds should not classified as “conflict minerals”.

10. Case Study: Chinese Ta Imports in the US

- Consider this scenario:
  - In 2012, imports of Ta into the US increased 55%, with the single largest exporter being China
  - Ta is extracted from coltan (and separated from Nb) via hydrofluoric acid treatment, to typically produce a c.99% Ta_2O_5 product (which is then further treated to make metal, powder, etc.). Post acid treatment, the “DNA” of the Ta is erased, given the severity of the acid, and hence it is impossible to genetically link the treated product back to its original source deposit. Almost all the Ta entering the US from China would be post-acid
  - It is likely that there is a range of Chinese processors, some using conflict minerals, some not. It is also quite likely that Ta from multiple sources is combined by processors, including conflict and non-conflict alike
- What will constitute a satisfactory response to a RCOI issued by a US Issuer to a Chinese Ta processor?:
  - Remember: “100% supplier response is not required, provided the Issuer reasonably designs the inquiry, performs it in good faith and does not ignore warning signs”
  - The “acid test” will be the results of the first round of reporting on 31 May 2014, combined with the 2013 Ta import data.
  - Possible scenario that China remains the largest exporter of Ta into the US, reporting Issuers are individually complying with the Legislation, but the aggregate industry implication is that conflict-sourced Ta is entering the US supply chain. Would this constitute a “warning sign” for an individual Issuer? How credible would the Legislation be if it didn’t?

11. Final Observations

- The eastern Congolese conflict continues:
  - There is a largely moot debate as to whether or not the conflict would persist, if there were no minerals:

    "There is also no direct casual link between coltan and violence against civilians, including the mass sexual violence that characterizes the conflict in the DRC. The fact that armed groups that control coltan mines and tax the coltan trade also commit rape and murder is incontrovertible. However, there is not evidence that this violence would stop if coltan disappeared from the equation." Michael West, "Coltan" (2011), p.5

  - The Presenter does not entirely agree with this statement. More to the point however, the minerals are there, the conflict persists and the trade in conflict minerals continues unabated
  - The M23 rebel group was recently reported to have killed 86 children; the Presenter recommends visiting a triage in Goma, to witness the 21st century's current iteration of human misery
- There are policy options available to the West that would be more effective:
  - Does the US have an effective Great Lakes policy? Is the Legislation a fig leaf for a meaningful and effective Congolese-centric US policy solution to the eastern Congolese conflict?
  - With the passing of the Clintonian era at State Department, there is an opportunity for the US to reconfigure its historical allegiances in the region, so that its broader policy orientation has the effect of curbing, rather than facilitating, the eastern Congolese conflict

12. Conclusion

- S.1502 of the Dodd-Frank Act, although well-intentioned, is offensive for the following reasons:

1. The Legislation (combined with the Final Rule) does not encompass all minerals from which rebel forces could benefit.
2. The implementation of the Legislation is ineffective and easily circumvented in practice, based upon evidence so far and the African experience with the Kimberley Process.
3. The trade in conflict minerals is continuing unabated.
4. The eastern Congolese conflict is continuing unabated.
5. The West's access to 3T metals as a result of the Legislation will be either more restricted and/or more expensive, for no reciprocal benefit.
6. Some Chinese and other less regulated operators are benefiting from the withdraw of some Western operators, vis-à-vis access to greater volumes of 3T metals and at cheaper prices.
7. A large number of African artisanal and small scale miners, in both conflict and non-conflict areas, have and will lose their only form of income and livelihood.
8. 2-7 above was not only forseeable, but inevitable.
9. The US has at its disposal practical and effective policy options which would undoubtedly curb or end the eastern Congolese conflict, should it wish to do so.

The end. Thank you for your attention