The Dodd-Frank Act’s Interventionist Approach to Business and Human Rights

Transparency, reporting and due diligence

In December 2010, the U.S. Securities and Exchange Commission (SEC) published proposed changes to the annual reporting requirements for issuers that file reports pursuant to the Exchange Act of 1934 to implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed rules will require any issuer for which conflict minerals are necessary to the functionality or production of a product manufactured or contracted to be manufactured by that issuer to disclose in the body of its annual report whether its conflict minerals originated in the Democratic Republic of Congo or an adjoining country. If so, the issuer should demonstrate the measures taken to exercise due diligence on the source and chain of custody of its conflict minerals. Next to the proposed rules on conflict minerals, the SEC has also issued rules on payments to third country governments. On 22 August 2012, the SEC has issued the final rules on both conflict minerals and payments.1 These interventionist rules are discussed, and compared with the EU amended Transparency Directive that will incorporate some similar yet different reporting requirements on business and human rights.

1. Introduction

For several years, multinational enterprises have been faced with allegations about their social and environmental performance, which is often captured in the term of corporate social responsibility. In particular the extractive industry has been targeted in the media and increasingly before the courts, e.g., the US federal courts (under the Alien Tort Statute), British, South African, French and Dutch courts.2 These cases all deal with the civil liability of corporations linked to alleged overseas international human rights violations (so-called ‘foreign direct liability’). Although most of these cases have been dismissed, some settlements and awards in these foreign direct liability cases before US and foreign (civil) courts have been substantial.3 Moreover, potential litigation can be devastating to a corporation’s image and investments from the capital market. According to this line of thought, being a good corporate citizen increases corporate image, the

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brand, and generates corporate goodwill and investments. From the victims’ perspective, holding corporations accountable through litigation faces many legal obstacles, which have been increasingly researched over recent years. Next to attempts to stretch traditional liability concepts into enterprise liability, a new approach of transparency is gaining importance as a viable alternative to regulate corporate conduct. Such a legislative, interventionist approach is the new US approach to corporate respect for human rights in the recently introduced US Dodd-Frank Wall Street Reform and Consumer Protection Act. This most recent development in demanding that corporations play a role in respecting international human rights may be the most potent one: the regulation of these social performance conditions through US securities law. Section 1502 of the Dodd-Frank Act seeks to achieve respect for human rights by leveraging a potent tool for corporate regulation available to the US government, i.e., US securities law, so as to attempt to end human rights violations and abuses in the eastern region of the Democratic Republic of Congo (DRC).

Signed into law on 21 July 2010, ‘the Dodd-Frank Act is the principal piece of financial industry reform legislation passed by U.S. Congress in response to the financial crisis that began in 2008’. Section 1502 is one of the few provisions in the Act that is directly aimed at foreign affairs, and the only one which directly addresses human rights. Section 1504 of the Act on the disclosure of payments by corporations to foreign governments for the commercial development of oil, natural gas or minerals has an indirect bearing on human rights, given that human rights abuses are often committed by the governments of countries with hydrocarbon or mineral wealth. Hereafter, this interventionist approach with extraterritorial implications of the Dodd-Frank Act will be further analyzed (sections 2 and 3). The scope and initial implications of this piece of securities law for corporations in the extractive industry are outlined and compared to the legislative reply by the EU (section 4). Finally, some concluding remarks are added in section 5. However, a brief overview of how these social conditions became part of securities law is first described.

1.1. A brief history of the inclusion of social provisions and securities law

The idea of ameliorating conflict in the eastern Democratic Republic Congo (DRC) by targeting the trade in tantalum, tin, tungsten and gold (see further below on Section 1502) has its philosophical roots in the Kimberley Process. The supply chain transparency for diamonds achieved through the Kimberley Process scheme could have a similar effect for conflict minerals from the DRC. The Enough Project of the Center for American Progress, a NGO combating human rights abuse, explained, ‘Electronics companies, can pressure their suppliers and trade the minerals they use.’ It thus sought to end the trade in conflict minerals by ‘shining a light on the supply chain.’ But supply chain transparency and US securities laws are different things. The history of the current Section 1502 did not begin with securities laws: originally, the initiators sought an outright ban on the import of conflict minerals. As a ban was not sufficiently supported, the Congo Conflict Minerals Act was introduced in April 2009. That bill, which ultimately became Section 1502, used reporting obligations for the SEC to bring transparency to the supply chain of conflict minerals. The securities law reporting requirements became the focus. In answering criticism of the bill’s alleged burdensome requirements on end-user companies, Senator Feingold dismissed it because ‘[a]imilar arguments were made in the early days of the Kimberley Process. Another bill in


5. See e.g. Eijsbouts, J. (2010), Elementaire beginselen van maatschappelijk verantwoord, in: A.J.A.J. Eijsbouts, F.G.H. Kirsten, J.M. Jongh & et al. (eds.), Preadies 2010 Nederlandse Juristen Vereniging over de civiel- en ondernemingsrechtelijke aspecten van Maatschappelijk Verantwoord Ondernemen, p. 39-122, Deventer: Kluwer 2010. Generally, enterprise liability is a tort law doctrine ‘that seeks to hold all individuals and entities engaging in a certain unsafe custom liable for any injuries that result from that custom. Under the enterprise liability doctrine, parties may be held liable even if the plaintiff cannot prove the parties’ fault.’ The central idea is that in certain industries (particularly those that are inherently hazardous), those who profit from the inherent risk in the activity deserve to bear the cost as a consequence of those profits. In other words, when whole industries are unsafe, the industry becomes jointly responsible for failing to address the hazards.’ Erika Johansen, ‘What is Enterprise Liability?’, available at: www.ehow.com/about_6506291_enterprise-liability_.html (last visited 1 September 2012). See on enterprise liability and interventionism in the field of business and human rights: M.J.C. van der Heijden, diss. Tilburg, April 2011, Concluding Chapter.

6. The Dodd-Frank Wall Street Reform and Consumer Protection Act – An Act to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail’, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes. Pub. L. No. 111-203, 124 Stat. 1376 (2006) (calling for disclosure of gap between senior-most executive compensation pay and the average worker’s pay); see also Amendments to Rules on Shareholder Proposals, 17 C.F.R. § 240 (2006), available at www.sec.gov/rules/final/34-4018.htm (‘We have gained a better understanding of the depth of interest among shareholders in having an opportunity to express their views to company management on employment-related proposals that raise sufficiently significant policy issues.’).


9. Ibid.

the House of Representatives introduced later in 2009 proposed to use US import laws to achieve the same transparency. It required importers to declare whether their products included designated minerals and whether the minerals used were conflict free and established a private auditor program of mineral processing facilities overseen by the US Department of Commerce. Aspects of that bill became part of Section 1502. On 18 May 2010, two days before the Senate’s approval of the Dodd-Frank Act, Senator Sam Brownback attached Section 1502 as an amendment, which was adopted by the Senate by voice vote.

The SEC has questioned the connection between investor protection and conflict minerals and therefore the appropriateness of the use of securities law for transparency on business and human rights. In its 2010 Proposed Rules, the following can be read: ‘It appears that the nature and purpose of the Conflict Minerals Provision is for the disclosure of certain information to help end the emergency humanitarian situation in the eastern DRC that is financed by the exploitation and trade of conflict minerals originating in the DRC countries, which is qualitatively different from the nature and purpose of the disclosure of information that has been required under the periodic reporting provisions of the Exchange Act.’

This may explain why the SEC has strictly adhered to the position of Congress, as witnessed in the statement of the SEC: ‘In adopting this statute, Congress expressed its hope that the reporting requirements of the securities laws will help to curb the violence in the eastern Democratic Republic of the Congo,’ said SEC Chairman Mary L. Schapiro. ‘Because expertise about these events does not reside within the SEC, we have drafted these proposed rules carefully to follow the direction of Congress and look forward to the additional insights and perspective from public comments.’

For many years, SEC however refrained from including disclosure rules that did not directly concern profit and loss. In recent years, the scope of mandatory reporting has expanded to include various subject areas relevant to the corporation’s treatment of the interests of stakeholders as well as handling negative externalities. As a result of several commissioned studies and of sustained and growing pressure by socially conscious mutual funds and public pension funds, ‘the scope of the subjects that Congress and SEC now assume falls within the interests of reasonable investors has broadened considerably.’

Subsequently, ‘[t]he strictures of the mandatory reporting system are being enlarged to require additional reporting of corporations’ environmental compliance, labor standards, executive compensation rates and policies, anti-corruption efforts and antidiscrimination policies.’

The recent Dodd-Frank Act includes socially significant disclosure mandates and further the combination of social conditions and investment in social responsible investment (SRI). The first, in Section 1502, mandates SEC rulemaking to require disclosure by public, listed companies – or subsidiaries or controlling entities of such companies – whose products use ‘conflict minerals’ that originate in the Democratic Republic of the Congo or adjoining countries that are also subject to ongoing, violent unrest. By including this provision, US Congress clearly promotes corporate human rights observance by US listed companies internationally.

The second socially significant disclosure mandate is found in Section 1504, which was introduced in the slipstream of Section 1502. This provision similarly requires US listed companies active in the extractive industry internationally to disclose payments made to foreign governments (and the US federal government) for mining rights, including the extraction of oil, natural gas and other minerals rights. The SEC had to define the disclosure requirements within more or less nine months to publish final regulations once the Act was adopted. In December 2010, the SEC published the Proposed Rules on both Sections 1502 and 1504. And recently, the final rules were issued on 22 August 2012. In formulating the precise disclosure requirements and conditions concerning the payments, in Section 1504, the SEC has been directed to take account of the international, non-binding merely voluntary, yet well-established guidelines of the Extractive Industry Trade Initiative (EITI).

In this article, this transitional moment in the development of disclosure requirements and society’s expectations concerning business and human rights as demonstrated in these two provisions and in the EU’s proposal to amend the Transparency Directive of October 2011 are further analyzed as the implications of these recent initiatives with which legislators intervene may be great and may be a start to a new way of holding corporations accountable for human rights violations.

14. Ibid., at 137.
15. The Act contains three such mandates in Sections 1502-1504. As Section 1503 is concerned with mine safety exclusively in the US which has no extraterritorial effects, this disclosure mandate is not dealt with here. Section 1503 Dodd-Frank Act on mining safety within the US has been endorsed by Congress because of several high-profile coal mining disasters in 2010. See further Pub. L. No. 111-203, 124, Stat. 2218-2220 (2006). See for the evaluation of the costs of reform involved: Griffin, Paul A., Lont, David H. and Sun, Yuan, Supply Chain Sustainability: Evidence on Conflict Minerals, August 14, 2012.
17. Ibid., at 2220-2221.
18. According to the SEC website. Furthermore, the final regulations on Section 1503 (US mining safety) have already been promulgated. See on early writing on this matter and in favour of full disclosure: F. Stevelman, Globalization and Corporate Social Responsibility, 53 N.Y.L. Sch. L. Rev. 817 (2009).
19. In February 2011, the new EITI rules were published. These are available at: http://eiti.org/document/rules (last visited 1 September 2012).
Conflict minerals disclosure under Section 1502

Dodd-Frank Act

2.1. The impetus

The motivation for the disclosure rules by the SEC under Section 1502 and Section 1504 has already been discussed in history of the provision outlined above. As the SEC restates, "Congress intended to further the humanitarian goal of ending the extremely violent conflict in the DRC, which has been partially financed by the exploitation and trade of conflict minerals originating in the DRC."20 This main idea is reflected in the title of Section 1502(a): "Sense of the Congress on Exploitation and Trade of Conflict Minerals Originating in the Democratic Republic of the Congo."21 The rationale of Congress in requiring this disclosure mandate and warranting the provisions of Section 13(p) of the Securities Exchange Act of 1934 – in short, employing securities law for this goal – is added by subsection (b), which reads as follows:

"It is in the sense of the Congress that the exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emerging humanitarian situation therein, warranting the provisions of section 13(p) of the Securities Exchange Act of 1934."

Thus, the financial resources that continue the violence in parts of DRC must be removed. To further this purpose, Section 1502 Dodd-Frank Act and the thereupon issued final rules provide for the conditions as to when, how and what extractive companies should publish what information. The conviction is that once the companies have to be transparent about the source and chain of custody of the employed minerals the investors are aware of their origins and will avoid socially irresponsible investments. And companies themselves will not extract these minerals.

2.2. Background: SEC’s final rules on conflict minerals

As Section 13(p) Securities Exchange Act mandates, the SEC has adopted a new form (Form SD, special disclosure) and rule pursuant to Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to the use of conflict minerals. Accordingly the SEC has promulgated final rules requiring issuers with conflict minerals that are necessary to the functionality or production of a product manufactured by such person to disclose annually whether any of those minerals originated in the Democratic Republic of the Congo or an adjoining country.

In short, the new final rules can be summarized as follows:

"If an issuer’s conflict minerals originated in those countries, Section 13(p) requires the issuer to submit a report to the Commission that includes a description of the measures it took to exercise due diligence on the conflict minerals’ source and chain of custody. The measures taken to exercise due diligence must include an independent private sector audit of the report that is conducted in accordance with standards established by the Comptroller General of the United States. Section 13(p) also requires the issuer submitting the report to identify the auditor and to certify the audit. In addition, Section 13(p) requires the report to include a description of the products manufactured or contracted to be manufactured that are not ‘DRC conflict free,’ the facilities used to process the conflict minerals, the country of origin of the conflict minerals, and the efforts to determine the mine or location of origin. Section 13(p) requires the information disclosed by the issuer to be available to the public on its Internet website."

The Dodd-Frank Act amends the Securities and Exchange Act by adding a new provision – 13(p).22 As these SEC final rules are new and rather foreign to securities law – since they are concerned with social conditions that aim to mitigate the human rights abuses in and surrounding the DRC instead of primarily informing the capital market and protecting investors and consumers – a closer look seems to be merited.

2.3. The conditions

This addition of adjoining countries means that it does not only concern minerals in the DRC but also the Central African Republic, Sudan, Uganda, Rwanda, Burundi, Tanzania, Zambia, Angola, and the Republic of Congo ("Covered Countries"). These countries are all included because the minerals that are tagged as conflict minerals are largely harvested in this region that is conflict-driven. Kenya has been excluded from the list. Although the reasons for its exclusion are not clearly mentioned, a reason may be that this country does not export or produce the minerals tagged as conflict minerals. The minerals that originate in the aforementioned countries and to be designated as conflict minerals were listed in the Proposed Rules as: tantalum (columbite-tantalite, coltan), cassiterite (tin), wolframite (tungsten) (known as the 3Ts), and gold. Furthermore, the Secretary of State could expand the list of minerals. With regard to tantalum, the SEC mentions that the inclusion of DRC and the adjoining countries count for 15-20% of the available

tantalum worldwide. As tantalum is used in electrical components in cell and smart phones, personal computers, videogame consoles and digital cameras, the impact of the disclosure requirements will probably be large. Not only will the extractive industry be directly affected, but also the electronic consumer industry must take account of these disclosure obligations as it may be implicated as well. For instance, companies like Nokia, Siemens, Philips, Ziggo, and KPN may all produce products which include tantalum. Cassiterite is used for tin and assemblies involving tin. Wolframite is employed in metal wires, electrodes, and contact points in lamps or heating. During the roundtable meetings, the stakeholders discussed the minerals concerned. Ultimately, the difficulty of not being able to further specify the derivatives of the 3Ts resulted in a somewhat moderated final rule: ‘The term “conflict mineral” in the final rule is defined to include cassiterite, columbite-tantalite, gold, wolframite, and their derivatives, which are limited to the 3Ts, unless the Secretary of State determines that additional derivatives are financing conflict in the Covered Countries, in which case they are also considered “conflict minerals,” or any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the Covered Countries.’

Where the designated minerals do not finance the conflict or benefit armed groups, the issuers may describe their minerals as ‘DRC conflict free’ in their specialized disclosure report, provided that they can demonstrate this qualification on the basis of nationally or internationally recognized due diligence measures. However, not all companies will be subject to the regulations as these disclosure requirements will only apply when the companies (including the controlling entities) have a listing in the US. Thus, American and non-American (such as Dutch or British) companies that have a listing at the New York Stock Exchange will fall within the scope of the new regulations concerning conflict minerals disclosure. The final rules apply to those issuers that file reports to the SEC under Sections 13(a) and 15(d) of the Exchange Act, which includes domestic US companies, foreign private issuers, and smaller reporting companies or that are listed on a US stock exchange. A debated delimitation of covered issuers is whether their conflict minerals are ‘necessary to the functionality or production of products manufactured or contracted by the issuer to be manufactured’ (Exchange Act Section 13(p)(2)(B)).

The SEC does not further define ‘manufacture’ nor does it determine ‘contract to manufacture’. Yet, the SEC does provide some guidance principles on the latter. For instance, the term should capture manufacturers that contract the manufacturing of components of their products. ‘Contract to manufacture’ is intended to include issuers that have some actual influence over the manufacturing of their products. As to the circumstances under which the issuer is contracting to manufacture, the SEC has changed the Proposed Rules in its final rules: ‘An issuer is considered to be contracting to manufacture a product depending on the degree of influence it exercises over the materials, parts, ingredients, or components to be included in any product that contains conflict minerals or their derivatives. The degree of influence necessary for an issuer to be considered to be contracting to manufacture a product is based on each issuer’s individual facts and circumstances.’

Thus, this explanation may be highly relevant for supply chain transparency. The SEC has moreover indicated circumstances that will not provide the necessary influence for disclosure: ‘if [the issuer’s] actions involve no more than: (a) specifying or negotiating contractual terms with a manufacturer that do not directly relate to the manufacturing of the product, such as training or technical support, price, insurance, indemnity, intellectual property rights, dispute resolution, or other like terms or conditions concerning the product, unless the issuer specifies or negotiates taking these actions so as to exercise a degree of influence over the manufacturing of the product that is practically equivalent to contracting on terms that directly relate to the manufacturing of the product; or (b) affixing its brand, marks, logo, or label to a generic product manufactured by a third party; or (c) servicing, maintaining, or repairing a product manufactured by a third party.’

In total, the SEC estimated that about 5,500 companies may use these minerals or products containing these minerals. Of the 5,500 companies, about 1,200 companies may use these minerals from the indicated region of and surrounding DR Congo. Consequently, the SEC estimates that this latter group will fall under the new regulations. These companies will have to publish a Conflict Minerals Report. The other 4,300 (5,500-1,200) companies should be aware of the new regulations, if they decide to use or extract the minerals in the defined region. As a major change to the Proposed Rules, the final rules ex-

26. See H.R. REP. No. 111-517, Joint Explanatory Statement of the Committee of Conference, Title XV, ‘Conflict Minerals’, at 879 (Conf. Rep.), June 29, 2010 (‘The conference report requires disclosure to the SEC by all persons otherwise required to file with the SEC for whom minerals originating in the Democratic Republic of Congo and adjoining countries are necessary to the functionality or production of a product manufactured by such person.’); 156 CONG. REC. S3976 (daily ed. May 19, 2010) (statement by Sen. Feingold) (stating that the ‘Brownback amendment was narrowly crafted’ and, in discussing the provision, referring only to ‘companies on the U.S. stock exchange’); 156 CONG. REC. SM465-66 (daily ed. May 18, 2010) (stating that the Conflict Minerals Jurisdictional Provision ‘is a narrow SEC reporting requirement’ and refers only to ‘SEC reporting requirements’ in discussing the provision); and 156 Cong. Rec. S3816-17 (daily ed. May 17, 2010) (statement by Sen. Durbin) (stating that the provision ‘would require companies listed on the New York Stock Exchange to disclose in their SEC filings’).
27. Final Rules, at p. 65.
28. One of the outstanding issues is whether companies in the recycling industry will also fall within the scope of Section 1522 Dodd-Frank Act.
clude mining companies that merely mine as they are not manufacturing.29

In determining whether its conflict minerals are ‘necessary to the functionality’ of a product, an issuer should consider: (a) whether a conflict mineral is contained in and intentionally added to the product or any component of the product and is not a naturally-occurring by-product; (b) whether a conflict mineral is necessary to the product’s generally expected function, use, or purpose; or (c) if a conflict mineral is incorporated for purposes of ornamentation, decoration or embellishment, whether the primary purpose of the product is ornamentation or decoration. Based on the applicable facts and circumstances, any of these factors, either individually or in the aggregate, may be determinative as to whether conflict minerals are “necessary to the functionality” of a given product.30

Once the conflict minerals are necessary for the production and all the other outlined conditions regarding the scope are satisfied, step one under the final rules has been taken.

2.4. Due diligence

Step two is to determine whether the conflict minerals have originated in the DRC or adjoining countries and if they do, the issuer must publish the relevant information in a Conflict Minerals Report. The final rules require a reasonable country by origin inquiry so as to satisfy its due diligence obligation. The final rules do not specify what steps and outcomes are necessary to satisfy the ‘reasonable country of origin inquiry’ requirement, because, as stated in the Proposing Release, such a determination depends on each issuer’s particular facts and circumstances. Such an inquiry can differ among issuers based on the issuer’s size, products, relationships with suppliers, or other factors. An issuer will satisfy the reasonable country of origin inquiry standard if it seeks and obtains reasonably reliable representations indicating the facility at which its conflict minerals were processed and demonstrates that those conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources.31 “These representations could come either directly from that facility or indirectly through the issuer’s immediate suppliers, but the issuer must have a reason to believe these representations are true given the facts and circumstances surrounding those representations. An issuer must also take into account any applicable warning signs or amount of its conflict minerals originated or may have originated in the Covered Countries.”32

The SEC approach to the reasonable country of origin inquiry is consistent with the supplier engagement approach in the OECD guidance33, where issuers use a range of tools and methods to engage with their suppliers. Under the OECD guidance, this is the first step that issuers must take to determine whether the further due diligence work outlined in the OECD guidance is necessary. The US conflict minerals provision contemplates due diligence, which goes beyond inquiry, and it involves further steps to establish the accuracy of relevant information, by requiring a description of the measures the issuer took to exercise due diligence on the source and chain of custody of the minerals. Besides, Congress specifically mentioned that due diligence shall include an independent private audit that must be publicly available at the company’s website, so as to bolster the accuracy of required information.34

On the latter, the audit must provide: (1) a description of the manufactured product or the agreed to manufactured product that is not free from these minerals35; (2) the locations where the minerals originated; (3) the country or countries where the minerals originated; and (4) information what the company has done to designate the mine or location of the minerals. The mine (or location) of the conflict minerals must be indicated ‘with the greatest possible specificity’.36

In sum, from the final rules it can be derived that, ‘if (i) based on its reasonable country of origin inquiry, an issuer determines that its necessary conflict minerals did not originate in the Covered Countries or did come from recycled or scrap sources, or (ii) based on its reasonable country of origin inquiry, the issuer has no reason to

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29. Final Rules, at p. 72.
30. Further guidance is provided with several examples in the Final Rules, at p. 84-91. No ‘de minimis’ is provided, see Final Rules, at p. 91 et seq.
31. See for the definition of the latter adopted by the SEC, in Final Rules, at p. 230: OECD, Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, 12 n.2 (2011), available at www.oecd.org/dataoecd/62/32/46740847.pdf. (Recycled metals 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 which contain refined or processed metals that are appropriate to recycle in the production of tin, tantalum, tungsten and/or gold. Minerals partially processed, unprocessed or a by-product from another ore are not recycled metals.). Note that recycled or scrap resources do not fall within the scope of the Final Rules, at p.231 et seq. (but if the issuer has reason to believe – following a reasonable country of origin inquiry – that the recycled or scrap resources are not from such sources, it must exercise due diligence as outlined, at p. 232).
32. Final Rules, at p. 149-150.
34. See Section 13(p)(1)(A)(1) Exchange Act. But the final rules clarify that the issuer’s audit certification does not need to be signed by an officer. The certification takes the form of a statement in the Conflict Minerals Report that the issuer obtained an independent private sector audit.
35. Literally: ‘DRC conflict free’, in Sections 13(p)(1)(A)(ii) en 13(p)(1)(D): products that do not contain conflict minerals that directly or indirectly finance or benefit armed groups in the DRC countries.
believe that its conflict minerals may have originated in the Covered Countries or the issuer reasonably believes that its conflict minerals are from recycled or scrap sources, the issuer is not required to exercise due diligence on its conflict minerals’ source or chain of custody or file a Conflict Minerals Report with respect to such conflict minerals. Instead, the issuer only is required, in the body of its specialized disclosure report, to disclose its determination and briefly describe the reasonable country of origin inquiry it undertook in making its determination and the results of the inquiry it performed. A Conflict Minerals Report is not required when the conflict minerals did not originate in the Covered Countries or came from recycled or scrap sources. However, the issuer is required to disclose the determination of the source and briefly describe its due diligence and the results thereof in the body of its specialized disclosure report. If the source cannot be determined, the issuer is required to submit a Conflict Minerals Report.

It is noteworthy that the SEC states that the OECD’s ‘Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas’ satisfies its criteria under the final rules and may therefore be used as a framework for purposes of satisfying the final rules’ due diligence requirement.

3. Payments to foreign governments

3.1. Introduction

Next to the Proposed Rules concerning the conflict minerals as mandated by Congress in Section 1502 Dodd-Frank Act, Congress has added Section 1504 for the SEC to do the same with regard to payments to (the US federal government and) foreign governments. Section 1504 thereby explicitly aims to amend Section 13(q) Securities and Exchange Act. Again, US-listed internationally extractive enterprises are to disclose payments to governments for the purpose of the commercial development of oil, natural gas or other minerals.

3.2. Background

On 22 August 2012, the SEC adopted new rules and an amendment to a new form pursuant to Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to the disclosure of payments by resource extraction issuers. Section 1504 added Section 13(q) to the Securities Exchange Act of 1934, which requires the SEC to ‘issue final rules that require each resource extraction issuer to include in an annual report of the resource extraction issuer information relating to any payment made by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government for the purpose of the commercial development of oil, natural gas, or minerals, including – (i) the type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals, and (ii) the type and total amount of such payments made to each government exercising authority over the issuer’s operations in that country’ in an interactive data format.

Congress enacted Section 1504 to increase the transparency of payments made by oil, natural gas, and mining companies to governments for the stated primary purpose ‘to help empower citizens of those resource-rich countries to hold their governments accountable for the wealth generated by those resources’.

The starting point in discussing the new disclosure conditions is Section 13(q) which provides the following definitions of several key terms:

37. Final Rules, at p. 152.
40. 124 Stat. 2220-2221.
41. Securities and Exchange Commission, 17 CFR Parts 240 and 249, Release No. 34-67717; File No. S7-42-10, Disclosure of Payments by Resource Extraction Issuers, 22 August 2012 (hereafter: final rules). A resource extraction issuer must comply with the new rules and form for the fiscal years ending after September 30, 2013. For the first report filed for the fiscal years ending after September 30, 2013, a resource extraction issuer may provide a partial year report if the issuer’s fiscal year began before September 30, 2013. The issuer will be required to provide a report for the period beginning October 1, 2013 through the end of its fiscal year. For any fiscal year beginning on or after September 30, 2013, a resource extraction issuer will be required to file a report disclosing payments for the full fiscal year. SEC adopts new Rule 13q-1 17 CFR 240.13q-1 and an amendment to new Form SD 17 CFR 249.448 under the Securities Exchange Act of 1934.
43. See, e.g., statement by Senator Richard Lugar, one of the sponsors of Section 1504 (‘Adoption of the Cardin-Lugar amendment would bring a major step in favor of increased transparency at home and abroad. (…) More importantly, it would help empower citizens to hold their governments to account for the decisions made by their governments in the management of valuable oil, gas, and mineral resources and revenues. (…) The essential issue at stake is a citizen’s right to hold its government to account. Americans would not tolerate the Congress denying them access to revenues our Treasury collects. We cannot force foreign governments to treat their citizens as we would hope, but this amendment would make it much more difficult to hide the truth.’), 156 CONG. REC. S3816 (May 17, 2010).
Section 13(q) specifies that ‘to the extent practicable, the rules issued under [the section] shall support the commitment of the Federal Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals.’ The statute explicitly refers to one international initiative, the Extractive Industries Transparency Initiative (‘EITI’), in the definition of ‘payment.’ This instrument is often referred to as a parameter for setting more precise terms.

3.3. SEC’s Final Rules concerning payments

In accordance with the Proposed Rules of December 2010, the SEC has adopted in its final rule on Section 1504 a definition of the term ‘resource extraction issuer’ as it is defined in Section 13(q). Consequently, the final rules on payments will apply to all US companies and foreign companies that are engaged in the commercial development of oil, natural gas, or minerals and that are required to file annual reports with the Commission, regardless of the size of the company or the extent of business operations constituting the commercial development of oil, natural gas, or minerals.

In light of Section 13(q), competitive concerns for larger and domestic companies and with a view to a level playing field, no exemptions for smaller or governmental-owned companies are available. The final rules leave no such possibility by providing disclosures of the payments under alternative regimes, such as home State laws including listing laws, or non-State rules, e.g., the EITI program. The SEC has also not allowed an exemption to the disclosure obligation in case foreign law may prohibit the required disclosure. The principal argument not to include such an exemption is that it may otherwise encourage countries to adopt such legislation and contravene the purpose of Section 13(q). Furthermore, contractual confidentiality clauses or provisions concerning commercially or competitive sensitive information prohibiting the disclosure are not an exemption under the final rules.

With regard to the term ‘foreign government’ – a term Section 13(q) stipulates that the SEC would further establish – it is found that the SEC does not further its definition. Rather, the SEC links up to the EITI: a foreign government includes ‘a foreign national government as well as a foreign subnational government (government

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44. 15 U.S.C. 78m(q)(1)(D).
49. The EITI is a voluntary coalition of oil, natural gas, and mining companies, foreign governments, investor groups, and other international organizations dedicated to fostering and improving transparency and accountability in countries rich in oil, natural gas, and minerals through the publication and verification of company payments and government revenues from oil, natural gas, and mining. See Implementing the Extractive Industries Transparency Initiative (2008) (‘Implementing the EITI’), available at http://eiti.org/document/implementingtheeiti.
50. According to the EITI, ‘[b]y encouraging greater transparency and accountability in countries dependent on the revenues from oil, gas and mining, the potential negative impacts of mismanaged revenues can be mitigated, and these revenues can instead become an important engine for long-term economic growth that contributes to sustainable development and poverty reduction.’ EITI Source Book (2005), at 4, available at http://eiti.org/files/document/sourcebookmarch05.pdf.
51. See the new Exchange Act Rule 13q-1 and final rule, at p. 28 sub c.
52. See for instance, the statement by Senator Richard Lugar, one of the sponsors of Section 1504 (‘Adoption of the Cardin-Lugar amendment would bring a major step in favor of increased transparency at home and abroad. (…) More importantly, it would help empower citizens to hold their governments to account for the decisions made by their governments in the management of valuable oil, gas, and mineral resources and revenues. (…) The essential issue at stake is a citizen’s right to hold its government to account. Americans would not tolerate the Congress denying them access to revenues our Treasury collects. We cannot force foreign governments to treat their citizens as we would hope, but this amendment would make it much more difficult to hide the truth.’), 116 CONG. REC. S3816 (May 17, 2010).
53. See Final Rules, at 28 (generally face greater equity risk from their operations in host countries than larger issuers).
54. See Final Rules, at 28, footnote 75 (‘not providing a carve-out from the rules for payments made by a government-owned resource extraction issuer to its controlling government because we believe it would be inconsistent with the purpose of the statute. We note a government-owned resource extraction issuer would only disclose payments made to the government that controls it if those payments were made for the purpose of commercial development of oil, natural gas, or minerals and the payments are within the categories of payments that would be required to be disclosed under the rules.’).
of a state, province, county, district, municipality, or territory under a foreign national government). Also the country in which the government entity is located should be identified for each payment. The emphasis on identifying the country furthermore means that the term ‘project’ is not further defined either. Consequently, understanding a project as a reporting unit is not allowed under the Final Rules, since such a unit may encompass an entire continent, and neither can a project be defined as a geologic basin as such a basin may cover more than one country, while Section 13(q) aims for ‘country-by-country’ disclosure. Besides, certain payments, such as royalties, cannot be aligned with a definition of a project along these lines either.

As disclosure is only necessary when the payments are linked to the commercial development of oil, natural gas, or minerals, a large deal will depend on the correct interpretation of commercial development. Therefore, the SEC had to and did elaborate extensively on the terms ‘commercial development of oil, natural gas, or minerals’ and furthermore clarified ‘payments’.

Section 13(q) provides that activities involving exploration, extraction, processing, and export, or the acquisition of a licence for any such activity fall within the definition of the ‘commercial development’ of oil, natural gas or minerals. Many have commented on proper definitions of this term. The final rules employ a broader definition than the EITI in this respect as the EITI primarily focuses on exploration and production. Some commentators would prefer a narrower definition that includes only upstream activities, i.e., exploration and extraction. The SEC did not follow this and the Commission did not use the definition in Rule 4-10(a)(16) of oil and gas activities: e.g., search for crude oil and natural gas, acquisition of property rights for the purpose of exploration, construction, drilling and production activities to retrieve oil and gas, which would exclude for instance the transportation of oil and gas. On the other hand, the SEC also did not broaden the definition; on the contrary, in light of legal certainty, the SEC deleted the phrase ‘and other significant actions relating to oil, natural gas, or minerals’ in Section 13(q). Subsequently, refining and smelter will not fall under the definition, as these processing actions are not explicitly listed in Section 13(q) and as these actions would go beyond the current requirements under EITI. On the other hand, the final rules are applicable to export activities from the host country. Thus, an extractive industry issuer that is merely engaged in the export of oil, gas or minerals will fall within the scope. However, the transportation of oil, gas or minerals for a purpose other than export will not fall under the payment disclosure obligations. In clarifying the scope, the SEC provides for the following example that distinguishes transportation from export: [U]nder the final rules, transporting a resource to a refinery or smelter, or to underground storage prior to exporting it, would not be considered ‘commercial development,’ and therefore, an issuer would not be required to disclose payments related to those activities. On the final issue of the types and amount of payments the final rules are quite thorough. First, the SEC adopts the list of payment types, as stipulated by Congress. Thus, the final rules are consistent with the enumerated payments in Section 13(q) that states that ‘payment’ includes: taxes, royalties, fees, production entitlements, bonuses, dividends, and payments for infrastructure improvements. Second, the SEC has made some additions and clarifications to this list of payment types in response to comments received from stakeholders.

According to the SEC, the types of payments and any ‘other material benefits’ as well as any other additions and clarifications to the payments should be part of the “commonly recognized revenue stream” for the commercial development of oil, natural gas, or minerals. As Section 13(q) instructs the SEC to use the guidance of the EITI where and to the extent practicable, the definitions and selection of the types of payments largely follow the international EITI. Consequently, dividends are added to the list of payment types required to be disclosed. Rental fees, entry fees, concession fees, and bonuses that include signature, discovery, and production bonuses are added as well. The EITI Resource Book specifically mentions these types of fees and bonuses as payments that are typically disclosed by EITI participants and these therefore belong to the commonly recognized revenue streams. Furthermore, the issuers must publish the taxes levied on corporate profits, corporate income, and production, but they will not be required to disclose payments for taxes levied on consumption, such as value-added taxes, personal income taxes, or sales taxes. In addition, in-kind payments, particularly in connection with production entitlements, are included. While payments related to infrastructure improvements – building roads, an airfield, etc. – are commonly addressed in contracts with governments and in practice, social and community improvements or benefits are not. Therefore, the issuers should disclose the first, not the latter payments.

A crucial and much-debated matter has been the phrase ‘not de minimis’ in Section 13(q) (rather than the use of a materiality standard, which is used elsewhere in the federal securities laws and in the EITI). The SEC points out that ‘not de minimis’ was not intended to equate to a materiality standard. In the final rules, the SEC defines ‘not de minimis’ to mean ‘any payment, whether made as a single payment or a series of related payments, that equals or exceeds $100,000 during the most recent fiscal year’. In the case of an arrangement providing for periodic payments (such as rental fees), resource extraction issuers must consider the aggregate amount of the related periodic payments or installments of the related payments.

55. Final Rules, at 102, and Item 2.01(c)(2) of Form SD. Finally, a payment to a third party to be paid to a foreign government on its behalf will also fall within the scope of the final rules and should be disclosed.
56. Final Rules, at 82.
in determining whether the payment threshold has been met for that series of payments, and accordingly, whether disclosure is required.’

While many companies that report under the EITI standards have reported payments in excess of $1,000,000, the SEC deviated deliberately because the EITI provides countries with the possibility to establish a ‘materiality’ level for disclosure, which, as noted, is different from the ‘not de minimis’ standard in Section 13(q) that Congress set. Besides, the SEC agrees with those commentators that cautioned against setting the threshold too high so as to leave important payment streams undisclosed. On balance, the SEC specified the threshold to be $100,000—a threshold many issuers will be expected to easily exceed.

As many have criticized the proposed rules on conflict minerals and payments due to their possible ambiguity, the SEC has further established with much more precision what the various terms and conditions must entail. However, it remains to be seen whether these disclosure rules will have the effect Congress had in mind when enacting these provisions of the Dodd-Frank Act. As these social disclosure provisions have kicked up some dust, many covered companies will closely study these new final rules. Furthermore, some have commented that from a level playing field perspective Europe should follow this US initiative of more transparency in the business and human rights field through securities law. Therefore, the final section briefly outlines the EU reply.

4. The EU approach: the amended Transparency Directive

4.1. Introduction

With regard to any EU regulation on conflict minerals, one can conclude that no such reply to the US example of Section 1502 Dodd-Frank Act is (yet) available. However, the EU approach to provide more transparency on the social issues in its Transparency Directive, which needed to be amended for several other reasons.60

The primary purpose of the proposal for the amended Transparency Directive is stated under the heading of General Context: the objective of maintaining and, where necessary, enhancing the level of investor protection envisaged in the Directive and ensuring that the information disclosed is sufficient and useful for investment purposes at acceptable cost.61 In the general context, there is no mention of social corporate performance, human rights or any other phrase that would hint that the EU is implementing some business and human rights conditions in its securities law.

4.2. Transparency on payments

Social and environmental conditions in the proposal are partially generated as a result of the resolution of the European Parliament that reiterated its support for country–by–country reporting requirements, in particular for the extractive industries.62 Also the European Commission has expressed its support for the EITI initiative.63

The main reason to include the conditions in this proposal, as outlined in the box below, is different to the US provisions discussed. It may be read that ‘payments made to governments in a specific country are normally not disclosed, even though such payments by the extractive industry (oil, gas and mining) or loggers64 of primary forests65 can represent a significant proportion of a country’s revenues, especially in third countries that are rich in natural resources’.66

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61. Ibid., p. 2.


64. Whether clear-cutting, selective logging or thinning, on land classified as containing primary forest areas or other disturbance of such forest or forest land caused by mining, mineral, water, oil or gas exploration or extraction or other detrimental activities.65

65. Defined in Directive 2009/28/EC as ‘naturally regenerated forest of native species, where there is no clearly visible indication of human activities and the ecological processes are not significantly disturbed.’


there are striking differences. For instance, the scope is clearly different: not only the listed corporations but also large private companies should report on these matters.68 Moreover, the timber industry is included next to the oil, gas and minerals extractive industry. The approach is also different as the EU clearly stated that it aims to change the behaviour of governments through obligations imposed on covered companies. The obligations are based on a company’s current structure and slightly different activities are covered in the proposal: exploration, discovery, development, and extraction activities, whereas the US final rules apply to exploration, extraction, processing, and export activities. Both the US final rules and the EU proposal aim for the EITI standard to report on a country-by-country basis (CBCR).69

In sum, although the EU proposal is the EU’s reply to similar social matters, it adds the environmental concern of logging and broadens the scope to large private companies as well. Next to the other mentioned differences, the EU proposal and the US final rules only seem to share the same common idea: more transparency on indicated business and human rights concerns through securities law.

5. Concluding Remarks

The article has described in some detail the new final rules that provide for social conditions as corporate performance in securities law. Sections 1502 and 1504 Dodd-Frank Act on respectively conflict minerals and payments to third countries in case a company is an issuer in the US are fine examples of an interventionist approach by the US legislator, since Congress intervened by requiring issuers to account for their activities in regions of the world where human rights violations are often committed. Whether the new disclosure requirements will effectively ameliorate the conflict in DRC and surrounding countries is still to be seen. However, the final rules issued by the SEC further develop the standard on due diligence in the business and human rights field. In its interventionist approach, the SEC is aligning with and is guided by the OECD and EITI standards and at some indicated instances the SEC goes beyond what these international standards are prescribing.

The EU has adopted a few comparable provisions in its amended EU Transparency Directive. These differ from the US final rules in several respects: the EU directive would apply to large, private EU-based companies as well as EU-listed companies engaged in oil, natural gas, minerals, and timber, whereas the US final rules only apply to Exchange Act reporting companies engaged in oil, natural gas, and mining. Furthermore, the Transparency Directive would require the disclosure of payments that are material to the recipient government, whereas the final rules require the disclosure of payments that are not de minimis. Besides, the EU directive would apply to exploration, discovery, development, and extraction activities, whereas the final rules apply to exploration, extraction, processing, and export activities. In addition, while both the EU directive and final rules require payment disclosure per project and government, the EU directive would base project reporting on a company’s current reporting structure whereas the final rules leave the term ‘project’ undefined.

As a result, European companies that fall under the EU Transparency Directive and under the US final rules on Sections 1502 and 1504 Dodd-Frank Act may encounter difficulties in the sense that they could be required to report under both regimes and, moreover, they should be aware of the examined different and even possible contradictory conditions.
