



**Before the  
U.S. Securities and Exchange Commission  
Washington, D.C. 20549**

<b>In the Matter of</b>	)	<b>Release No. 34-63547</b>
	)	
<b>Public Comments</b>	)	<b>File No. S7-40-10</b>
	)	
<b>Proposed Rule: Conflict Minerals</b>	)	<b>75 Fed. Reg. 80,948 (Dec 23, 2010)</b>

**SUPPLEMENTAL COMMENTS OF THE COMPETITIVE ENTERPRISE INSTITUTE**

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On behalf of the Competitive Enterprise Institute (CEI), a non-profit public policy organization that specializes in regulatory issues, we respectfully submit this supplement to our previously filed comments in the matter of the U.S. Security and Exchange Commission's *Proposed Rule: Conflict Minerals*.<sup>1</sup> This letter discusses recent developments occurring after the close of the comment period, including industry efforts that advance the rules' goals through innovative means and how the conflict mineral provision of Dodd-Frank is already having negative consequences for the people of the Democratic Republic of the Congo (DRC). We wish to reaffirm our caution that "this flawed but well-intentioned law must be implemented narrowly and carefully" to "limit the harmful effects" on American commerce and competitiveness and on legitimate mining in the very regions the law intends to help.<sup>2</sup>

The comments discuss the following points:

1. Similar forced supply chain audits and disclosures for blood diamonds have failed.
2. Forced supply chain audits and disclosures will likely increase the violence in the DRC, contrary to the legislation's intent.
3. Forced supply chain audits and disclosures will impose massive costs on U.S. companies.

### **I. Previous Supply Chain Audits and Disclosures Have Failed:**

Like Section 1502 of Dodd-Frank, the Kimberley Process Certification Scheme (KPCS) was designed to keep certain categories of another mineral, diamonds, out of the international market.<sup>3</sup> Unlike Section 1502, the KPCS was a deliberative, multilateral process that attempted to minimize harm to legitimate mining activities in the region. Nevertheless, due to the inefficiencies of international embargoes and the difficulty of verifying the source of fungible minerals like diamonds, the KPCS has largely failed.

#### **KPCS is Dramatically Ineffective:**

Even though KPCS is supported by most nations in the world, including the U.S. government, and international organizations like the United Nations, it has been stunningly ineffective at keeping conflict diamonds off the market.<sup>4</sup> The KPCS' auditing system has been tried in the

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<sup>1</sup> Comments of John Berlau and Anna Stanford, Competitive Enterprise Institute, Release No. 34-63547; File No. S7-40-10 (filed Mar. 2, 2011), <http://www.sec.gov/comments/s7-40-10/s74010-160.pdf>.

<sup>2</sup> Ibid.

<sup>3</sup> *Loupe Holes: Illicit Diamonds in the Kimberley Process*, Global Witness, November 2008, <http://www.globalwitness.org/library/loupe-holes-illicit-diamonds-kimberley-process>.

<sup>4</sup> Ibid, at 5.

Ivory Coast, DRC, Angola, and South America. In each situation it is unable to keep conflict diamonds out of the market.<sup>5</sup>

The system is afflicted by incentive issues whereby the benefits of non-cooperation with the KCPS are greater than the costs of non-cooperation. Thus, in practice, diamond dealers and other unscrupulous individuals have an incentive to undermine the KCPS rules at every turn. Consequently, the KCPS is ineffective at monitoring diamonds and has pushed more diamonds into the black market.

#### Section 1502 of Dodd-Frank Will Be Ineffective:

Section 1502 of Dodd-Frank suffers from more incentive problems than the KCPS. Many nations in the world at least attempt to adhere to the KCPS legislation, but Section 1502 will only apply to American firms. This means that miners will just sell their minerals to non-American firms, resulting in different allocations and customers for the same product. At best, Dodd-Frank will just result in a reshuffling of customers at huge regulatory expense for American firms.

The Commission should consider these facts in crafting its rules, and look to measures that will comply with the letter of the law while also avoiding the shortcomings of the KCPS discussed above.

#### **II. Impact on DRC Violence:**

The proposed rule will not diminish violence but rather destroy employment opportunities for the artisanal miners in the DRC.<sup>6</sup> Many of the artisanal miners in the DRC are demobilized government soldiers or rebels.<sup>7</sup> If their employment in the mining industry is decimated by Dodd-Frank, the next best options for many of them will be to rejoin the army, rebel war bands, or other criminal groups.

There are already indications that Dodd-Frank has had damaging consequences for the artisanal miners. In a recently published New York Times op-ed, freelance reporter David Aronson observed that the law is harming the very people it is aimed at protecting, and that the sole

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<sup>5</sup> Ibid, at 2-3.

<sup>6</sup> Heather Murdock, *Congo's riches below ground bankroll violence above*, WASHINGTON TIMES, May 18, 2011, <http://www.washingtontimes.com/news/2011/may/18/congos-riches-below-ground-bankroll-violence-above/>, Laura Seay, *Congo conflict minerals bill hurts miners it hopes to help*, THE CHRISTIAN SCIENCE MONITOR, July 18, 2011, <http://www.csmonitor.com/World/Africa/Africa-Monitor/2011/0718/Congo-conflict-minerals-bill-hurts-the-miners-it-hopes-to-help>.

<sup>7</sup> Comments of Josué Mukulumanya, President, and Emmanuel Byomunjira, Générale des Coopératives Minières du Sud Kivu (GECOMISKI), République démocratique du Congo, Release No. 34-63547; File No. S7-40-10, at 4 (filed Apr. 8, 2011), <http://www.sec.gov/comments/s7-40-10/s74010-219.pdf>.

beneficiaries are those perpetrating the violence.<sup>8</sup> The application of the Commission's proposed rules will likely exacerbate the adverse effects already seen in the DRC.

#### Rules Threaten to Increase Likelihood of Continued Violence:

Due to the enormous anticipated cost of complying with Section 1502, many firms might altogether forgo business with the DRC. The employment history of many artisanal miners suggests that if they are put out of work, many of them may return to fighting for the militias to support themselves and their families. This will likely aggravate ongoing violence and the broader conflict more than continued mining, even if some portion of the mining revenues is captured by currently warring parties.<sup>9</sup> Lowering the opportunity cost of joining a war band perpetrating crimes of rape, pillage, and slaughter will likely increase the quantity of warriors supplied and, concomitantly, the quantity of rape, pillage, and slaughter carried out by said war band. Since the goal of Section 1502 of the Dodd-Frank Act was to decrease the supply of violence in the DRC, this proposed rule should be reexamined with that in mind.<sup>10</sup>

#### **III. Impact on US Companies:**

The proposed rules will have a tremendous impact on a large number of companies and force those companies to incur massive costs for successful compliance. The rules force companies to expend significant resources in auditing their supply chains and disclosing their efforts to the Commission and the public while contributing little to effectuating the stated policy goals of Section 1502 of the Dodd-Frank Act.<sup>11</sup> To minimize these costs at a time when the U.S. economy is very fragile, we reaffirm our recommendation that the Commission interpret Section 1502 to apply only to newly extracted or mined gold and minerals and not to finished products. We also reaffirm our suggestion that companies making basic declarations of "no evidence" of mining in the regions should not be subjected to further oversight or third-party audits.

#### Companies Affected by the Proposed Rules:

If implemented broadly, a significant amount of U.S. companies will fall under the ambit of the proposed rules. While the Commission estimates the rules will apply to approximately 6,000 companies, the actual number of companies subjected to their repercussions is likely much higher. Lawrence Heim of Elm Consulting Group International estimates at least 12,000

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<sup>8</sup> David Aronson, *How Congress Devastated Congo*, NY TIMES, Aug. 7, 2011,

[http://www.nytimes.com/2011/08/08/opinion/how-congress-devastated-congo.html?\\_r=1](http://www.nytimes.com/2011/08/08/opinion/how-congress-devastated-congo.html?_r=1).

<sup>9</sup> Jon Rosen, *New U.S. law aims to clean up Congo mineral trade*, MINNPOST, May 5, 2011,

[http://www.minnpost.com/globalpost/2011/04/05/27170/new\\_us\\_law\\_aims\\_to\\_clean\\_up\\_congo\\_mineral\\_trade](http://www.minnpost.com/globalpost/2011/04/05/27170/new_us_law_aims_to_clean_up_congo_mineral_trade).

<sup>10</sup> Devon Maylie, *Firms Seek Supply Route Around Conflict in Congo*, WALL ST. J., Apr. 27, 2011,

<http://online.wsj.com/article/SB10001424052748704530204576236132463855532.html>.

<sup>11</sup> Devon Maylie, *Firms Seek Supply Route Around Conflict in Congo*, WALL ST. J., Apr. 27, 2011,

<http://online.wsj.com/article/SB10001424052748704530204576236132463855532.html>.

companies will be affected by the rules, reasoning that many suppliers may not be directly subject to the rules but nevertheless affected by the compliance efforts of issuers.<sup>12</sup>

This number could grow even higher, as many companies will likely be unable to verify that products they contract to carry are wholly conflict-mineral free.<sup>13</sup> Companies subject to the rules are spread over an array of industries, from high-tech field to food and beverage producers, as well as energy and medical technology sectors.<sup>14</sup> How far reaching these rules will ultimately be remains unclear, but it likely farther than Congress imagined or intended.

#### Compliance Costs of the Proposed Rules:

Given the scope of the rules and the ramifications they will have across the global market, the costs of compliance will be enormous. The Commission approximates the total increase in “company personnel time” for issuers to comply with the proposed rules to be 153,864 hours.<sup>15</sup> It further estimates the costs of hiring “outside professionals” necessary for compliance at over \$70,000,000.<sup>16</sup>

However, the National Association of Manufacturers offered its own estimates of the implementation costs for US industry, asserting that it will more likely be between \$9-16 billion.<sup>17</sup> This view is shared by the IPC Association Connecting Electronics Industries and the National Retail Federation; the latter suggested this increased cost will cause retailers to encourage their suppliers to buy from alternate markets, incurring costs and also undermining the policy goals underlying the legislation.<sup>18</sup>

These costs will come in the form of additional scrutiny required of a company’s supply chains, as well as the expenses of compiling a Conflict Minerals Report in the event a company cannot verify the absence of conflict minerals in its products. These reports require companies to detail their due diligence efforts with regard to their supply chains, and must be vetted by an independent private-sector auditor.<sup>19</sup> The burden on businesses will be significant.

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<sup>12</sup> Lawrence Heim, *Conflict Minerals Law, Supply Chain Due Diligence and Impact on Metal Buying Organizations – Part Three*, METALMINER, Feb. 25, 2011, <http://agmetalmminer.com/2011/02/25/conflict-minerals-law-supply-chain-due-diligence-and-impact-on-metal-buying-organizations-part-three/>.

<sup>13</sup> Comments of Erik O. Autor, Vice President and Int’l Trade Counsel, National Retail Federation, No. 34-63547; File No. S7-40-10-103 (filed Mar. 2, 2011) at 3, <http://www.sec.gov/comments/s7-40-10/s74010-103.pdf>.

<sup>14</sup> Marshall Chase, BSR, Conflict Minerals Reporting Regulations: Who is Covered? Jan. 2011,

<sup>15</sup> Conflict Minerals; Proposed Rule, 75 Fed. Reg. 80,965 (Dec. 23, 2010).

<sup>16</sup> *Ibid.*

<sup>17</sup> Comments of Stephen Jacobs, Senior Director of International Economic Affairs, National Association of Manufacturers, Release No. 34-63547; File No. S7-40-10-183, at 2 (filed Mar. 2, 2011), <http://www.sec.gov/comments/s7-40-10/s74010-183.pdf>.

<sup>18</sup> Comments of Fern Abrams, Director of Government Relations and Environmental Policy, IPC Association Connecting Electronics Industries, Release No. 34-63547; File No. S7-40-10-131 (filed Mar. 2, 2011), <http://www.sec.gov/comments/s7-40-10/s74010-257.pdf> [hereinafter IPC comments]; Author, *supra* note 2, at 3.

<sup>19</sup> Conflict Minerals; Proposed Rule, 75 Fed. Reg. 80,971, 972 (Dec. 23, 2010).

A troubling aspect about the significant cost is the concern that the rules may not have much impact on the violence, or as indicated above may actually increase the violence. Securities attorney David Johansen observed, “[n]o one in the United States condones what’s happening in the Congo, but the requirements are so expensive compared to the effect it might actually have in the Congo.”<sup>20</sup> As discussed below, the costs imposed by these rules will likely hinder existing efforts to bring peace and stability to the region, all at the expense of American businesses.

#### Proposed Rules Put U.S. Companies at Disadvantage:

The Commission’s rules will also place many U.S. companies at competitive disadvantage to foreign companies not subject to such rules. As the IPC suggests, the Commission could mitigate that disadvantage somewhat by phasing in implementation of the rules, thereby allowing companies a chance to cooperate on compliance initiatives and lessen the burden.<sup>21</sup>

Unfortunately whether implementation is delayed or immediate, foreign companies not subject to the Commission’s authority will maintain their supply of conflict minerals, undermining legitimate efforts undertaken by companies to achieve clean supply chains.

#### Rules Threaten Industry Pre-Existing Industry Initiatives:

Among the other troubling aspects of the Commission’s pending rules is the detrimental effect they will have on efforts by industry leaders to work with local groups in curbing the conflict mineral trade. Motorola’s “Solutions for Hope” program is one example of these efforts.<sup>22</sup> Motorola recognized that the rapid implementation of the Commission’s rules would have the equivalent effect of a “de facto embargo” of minerals from the DRC and surrounding countries, and is working with bona fide mining groups and others in the DRC to develop completely transparent supply chains. It bears mentioning that the rules’ effects outside the DRC may have devastating consequences for surrounding countries as well, including economic destabilization.<sup>23</sup>

Yet many companies, when faced with the high costs described above, will lack the incentive to undertake such creative measures and will seek alternative markets, exacerbating the poor conditions in the region. If Motorola’s program succeeds, it could inspire other companies to follow those steps and hasten the return of peace and stability to the DRC.

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<sup>20</sup> *DRC: Controversy over “conflict minerals” law*, IRIN, Aug. 2, 2011, <http://www.irinnews.org/printreport.aspx?reportid=93396>.

<sup>21</sup> IPC Comments, *supra* note 8, at 4-5, 19.

<sup>22</sup> Press Release, Motorola Solutions, Motorola Solutions Announces Project to Source Conflict-Free Tantalum from Democratic Republic of Congo (July 7, 2011), <http://mediacenter.motorolasolutions.com/Press-Releases/Motorola-Solutions-Announces-Project-to-Source-Conflict-Free-Tantalum-from-Democratic-Republic-of-Congo-36a1.aspx>.

<sup>23</sup> Comments of Jabu Maphalala, Secretariat, Mining Industry Associations of Southern Africa, Release No. 34-63547; File No. S7-40-10-96 (filed Mar. 2, 2011), <http://www.sec.gov/comments/s7-40-10/s74010-96.pdf> (discussing the adverse consequences posed by the Commission’s proposed rules on surrounding countries).

The Commission should recognize the value of programs such as “Solutions for Hope” and craft measures that may be taken to reduce the burden on companies and incentivize these types of programs, thereby bringing about substantial results for the Congolese people. Innovative solutions like Motorola’s are a means of achieving real success in the DRC and should not be discouraged. As we recommended in our original comments, companies should be allowed to rely on their own verification systems with no further action required, unless it is found that knowingly false statements have been made.

**Conclusion:**

A previous government attempt to audit and monitor the supply chains of miners of a fungible mineral through the KCPS failed.<sup>24</sup> Section 1502 of Dodd-Frank is similarly flawed. But even if Dodd-Frank dramatically reduces the use of conflict minerals by American firms, there is a very good chance that the reduction will do little to quell the violence in the DRC and may increase it. The next best financial opportunity for many miners is to join a violent war band. Section 1502 of Dodd-Frank will unintentionally make that choice more relatively attractive by closing off profit opportunities for many miners. The SEC should do all it can in implementing the provision to minimize these harmful effects.

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<sup>24</sup> Global Witness, *supra* note 2.