

Date of Hearing: July 6, 2011

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE
ECONOMY

V. Manuel Pérez, Chair

SB 861 (Corbett) – As Amended: May 31, 2011

SENATE VOTE: 33-2

SUBJECT: Public contracts: Ineligibility of scrutinized companies

SUMMARY: Prohibits specified companies from bidding on or submitting a proposal for a contract with a state agency to provide goods or services if said companies have had a final judgment filed against them by the U.S. Securities and Exchange Commission (SEC) related to the Democratic Republic of Congo (DRC) and conflict minerals disclosure. Specifically, this bill:

- 1) Makes legislative findings and declarations, which, among other things state:
 - a) The DRC was devastated by a civil war (1996 and 1997) and a war (1998 and 2003) which resulted in widespread human rights violations and the intervention of multiple armed forces or armed non-state actors from other countries in the region. Despite the signing of a peace agreement, the eastern region of the DRC has continued to suffer from high levels of poverty, insecurity, and a culture of impunity, in which illegal armed groups and military forces continue to commit widespread human rights abuses.
 - b) A report released by the U.S. Government Accountability Office (GAO) in December 2007 describes how the mismanagement and illicit trade of extractive resources from the DRC supports conflict between militias and armed domestic factions in neighboring countries.
 - c) According to a study by the International Rescue Committee released in January 2008, conflict and the related humanitarian crisis in the DRC have resulted in the deaths of an estimated 5,400,000 people since 1998 and continue to cause as many as 45,000 deaths each month. Sexual violence and rape remain pervasive tools of warfare used to terrorize and humiliate communities.
 - d) In February 2008, the United Nations Group of Experts on the DRC stated, "Individuals and entities buying minerals from areas of the eastern part of the DRC with a strong rebel presence are violating the sanctions regime when they do not exercise due diligence to ensure their mineral purchases do not provide assistance to illegal armed groups."
- 2) Prohibits a scrutinized company, as defined, from bidding on a state goods or services contract. This prohibition is limited to products or services related to the reason the company was found to be a scrutinized company by the SEC.
- 3) Defines "scrutinized company" to mean a person found to be in violation of Section 13(p) - Disclosures relating to Conflict Minerals Originating from the DRC of the Securities Exchange Act of 1934 (DRC Act) by final judgment or settlement entered in a civil or

administrative action brought by the SEC and the person has not remedied or cured the violation in a manner accepted by the SEC on or before final judgment or settlement.

- 4) Deems that a person is no longer regarded as a scrutinized company when the person is no longer in violation of the DRC Act, or three years from the date of final judgment or settlement, whichever is earlier.
- 5) Specifies that the provisions of this bill become inoperative upon the termination of the conflict mineral disclosure requirements.

EXISTING FEDERAL LAW:

- 1) Establishes the 2006 Democratic Republic of Congo Relief, Security, and Democracy Promotion Act (DRCRSDP Act). The DRCRSDP Act stated that it is the policy of the U.S. to work for peace and security throughout the DRC by supporting efforts to protect civilians, disarm illegal armed groups, and hold accountable individuals and entities working to destabilize the country.
- 2) Establishes the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), pertaining to the trade of minerals associated with the DRC conflict. The Dodd-Frank Act was signed into law adding, amongst other things, Section 13(p) to the Securities Exchange Act of 1934, known as the DRC Act, which directs the SEC to publish new disclosure rules by April 17, 2011, for publically traded companies reporting to the SEC for whom "conflict minerals" are necessary to the functionality or production of a product manufactured by such persons.

EXISTING STATE LAW:

- 1) Authorizes contracting between state agencies and private contractors and sets forth requirements for the procurement of goods and services by state agencies, and the various responsibilities of state agencies and the Department of General Services (DGS) in implementing state contracting procedures and policies.
- 2) Prohibits persons engaging in investment activities in Iran's energy sector, as specified, from bidding or entering into contracts with a public entity for goods or services.
- 3) Prohibits companies involved in specified business activities in Sudan from entering into a contract with a state agency for goods and services and requires a prospective bidder for a state contract to certify that the company is not engaged in such activities. Specifies penalties for submitting a false certification.

FISCAL EFFECT: Unknown

COMMENTS:

- 1) Author's purpose: According to the author's office, "Greed for the Congo's mineral wealth has been a prime cause of atrocity and conflict. Multiple armed groups use mass rape as a strategy to intimidate and control communities as they profit from the illicit trade of the

Congo's conflict minerals, such as tin, tungsten, and tantalum. Many of these same conflict minerals end up in our electronic devices, such as cell phones, laptops, and digital cameras.

"Secretary of State Hillary Clinton called the situation 'truly one of mankind's greatest atrocities.' The United Nations (U.N.) has recorded at least 200,000 cases of sexual violence in the eastern Congo? California is home to many computer and cell phone companies. The State of California should not spend tax dollars on companies that fail to comply with federal law.

"In order to encourage compliance with federal law, SB 861 prohibits publicly traded companies that have been found to be in violation of the reporting requirements under the Dodd-Frank Act by final judgment from obtaining procurement contracts with the state through the DGS until they comply with the law."

- 2) Background on DRC: The DRC is Africa's third largest nation (71.7 million people), located in Central Africa, northeast of Angola, with a narrow strip of land that controls the lower Congo River and is the only outlet to the South Atlantic Ocean. For



comparison, the country is slightly less than one-fourth the size of the U.S. Key exports include diamonds, gold, copper, cobalt, wood products, crude oil, and coffee. China is the largest foreign market for DRC goods, representing 46.75% of all DRC exports, followed by the U.S. at 15.35%, Belgium at 10.68%, and Zambia at 5.78%.



According to the World Fact Book, the DRC's economy has the potential of generating substantial wealth based on its reserves of natural resources. The country has, however, experienced decades of economic decline brought-on by long standing internal conflicts and systemic corruption since its independence in 1960. While the economic conditions began to improve in late 2002 with the withdrawal of a majority of the invading troops from neighboring African nations, progress has been slow. Renewed activity in the mining sector is the source of most DRC export income, temporally increased the country's fiscal position between 2006-2008, however, the fall in world market prices for key mineral exports in 2009 again weakened mineral exports. The world recession reduced overall economic growth in the DRC in 2009 to half of that in 2008, although 2010 GDP growth is estimated at 6%. The current government presides over what the GAO describes as "an unstable security situation, weak governance, mismanagement of its vast natural resources, and lack of infrastructure are major interrelated challenges that impede efforts" to address key domestic issues.

- 3) Impact of the social and economic unrest on communities: For more than a decade, various federal and international government and nongovernmental organizations (NGOs) have expressed concern that the DRC is the site of one of the world's worst humanitarian crises. Since 1998, an estimated 5 million have died as a result of the conflict. Sexual violence and rape are reported as being widely used to terrorize and control communities in the eastern region of the DRC in order to keep the mineral trade flowing and financing illegal armed groups and military forces.

As recently as September 2010, the GAO published a new report that examined the connection between minerals trade and human rights abuses. In its work, the GAO reviewed documents and interviewed officials from the U.S. Department of State, other U.S. agencies, the U.N., and foreign governments, as well as representatives from NGOs and industry.

In its report, the GAO traces the similar supply chains of tin, tantalum, and tungsten (key minerals mined in eastern DRC), which are mined by hand, sold to small-scale traders, carried by porters, transported by truck or airplane to the border, and sold to trading houses for export. From there, the minerals travel to neighboring African nations, such as Rwanda, and most are processed in Asia for use in technology products, such as mobile telephones. In contrast, gold, another important DRC mineral, is smuggled directly out of the DRC and is ultimately used by the jewelry and manufacturing industries.

The GAO report affirms that "illegal armed groups and some Congolese national military units commit human rights abuses and are involved in the mineral trade." The report suggests that the mineral trade, however, is not the root cause but one of many factors perpetuating the long-standing conflict. The GAO report criticizes the U.S. and the international community's efforts to address the extreme situation in the DRC as still being in preliminary action stages. As an example, the GAO report cites that the U.S. State Department's "white paper" on the DRC lacks concrete, actionable steps regarding the U.S.'s contribution to help control the conflict mineral trade. The provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 are, however, highlighted as one of the few significant and concrete steps U.S. agencies are undertaking to address the situation.

- 4) Conflict minerals : The term "conflict minerals" for purposes of the DRC Act includes columbite-tantalite (coltan), cassiterite, gold, wolframite or their derivatives, or any other mineral or its derivative determined by the U.S. Secretary of State to be financing conflict in the DRC or an adjoining country.

Conflict minerals are used widely by many industries. For example, wolframite is the main source of the metal tungsten, which is used to make cutting tools for various industries. Tungsten is also used to make filaments in light bulbs, turbine engines for aircraft and energy generation and in various electronic components. Cassiterite is used in the production of tin, which, in turn, is used in the solder that joins electronic components together and as an alloy for other metals to prevent corrosion. Columbite-tantalite is used mainly in the manufacture of condensers and micro-electronic technology (chips and processors), cell phones and nuclear reactors. It is also used in the production of certain varieties of steel. Gold is used for both industrial and commercial purposes including such products as jewelry, electronics, communications and aerospace equipment.

- 5) Federal Act and regulations: The DRC Act requires new disclosures by companies concerning their potential use of conflict minerals that originated in the DRC. More specifically, the DRC Act, requires companies to disclose annually whether they use "conflict minerals," which are "necessary to the functionality or production" of a product that they either manufacture, or contract to be manufactured, that originate from the DRC or adjoining countries.

In December 2010, the SEC released draft rules of the implementation of DRC Act. The DRC act uses the terms "person" and the proposed rule uses the term "issuer," referring to any entity that issues a security, such as publically held stock. For the purposes of this analysis, the term "company" will be used as it more appropriately applies to the prohibition in SB 861 against contracting with certain scrutinized companies. Among key elements of the proposed SEC rule, not already discussed, are the following:

- a) The requirements of the proposed rule applies equally to domestic and foreign companies.
- b) This disclosure is required to be based on a reasonable inquiry into the country of origin of potential conflict minerals.
 - i) If a company concludes that the minerals it uses did not originate in the DRC or neighboring countries, the company would disclose this determination and the due diligence efforts it undertook in reaching this determination. This "DRC conflict free" disclosure would then be hosted on the company's Internet website making the information easily known to the public including government entities such as DGS.
 - ii) If the company concludes that its minerals did originate in the DRC or an adjoining country, or the company is unable to conclude that its minerals did not originate in the DRC or adjoining country, the company is required to disclose these conclusions. This disclosure must be hosted on the company's website, be made as an exhibit to the company's annual report, and A Conflict Minerals Report, as described below, is required to be submitted to the SEC.
- c) The Conflict Minerals Report is required to include a description of the measures the company has taken to exercise due diligence on the source and chain of custody of its conflict minerals, including a certified independent private sector audit of the Conflict Minerals Report that identifies the auditor. The Conflict Minerals Report is also required to include a description of products manufactured or contracted to be manufactured containing conflict minerals and the facilities used to process those conflict minerals.

The SEC has authority to take action against companies that fail to comply with the DRC Act for the period covering the first full fiscal year following the promulgation of the rule. Although due in April 2011, the final regulations have not been filed by the SEC.

SB 861 would prohibit a state agency to contract with a company that has been found to be a company in violation of the DRC Act by final judgment or settlement, and the company has failed to remedy or cure the violation in a manner acceptable to the SEC. The bill has no known opposition, including the business community directly impacted by the provisions of the measure. This is, in part, because of the seriousness of some mineral extraction activities financially supporting paramilitary and illegal military activities which has led to extreme acts of violence against the innocent. In addition, the author has chosen a trigger mechanism for state sanctions that does not take effect until a company has had an opportunity to fully exercise all appeals before the SEC.

- 6) Power of disclosure: In an increasingly violent world where drug cartels, terrorist groups and unauthorized paramilitary directly challenge government controls and the safety of individuals, coordinated actions by a broad-base of international players can be effective. At one time, the actions and influence of these groups were isolated to specific regions. Today,

however, given the ease of travel and global supply chains for even simple products, such as light bulbs, geographic boundaries have become less important.

In the specific case of the DRC, minerals essential to the production of advanced technology devices (including for military/national security purposes) have been documented as being controlled by groups of violent individuals engaged in ongoing illegal activities. This situation results in providing both a protected location for the nurturing of illegal military "safe havens," as well as providing a lucrative funding source for continuing the terrorists/paramilitary activities. SB 861 leverages SEC's mandate to bring greater transparency to the extraction and movement of conflict minerals. Collectively, these measures and others across the world change the financial risk/reward system for using conflict minerals by creating added value for utilizing legitimate mineral extraction facilities and potentially opening new markets and opportunities for "DRC conflict free" products.

- 7) Amendments: Staff understands that that the following amendments will be proposed at the hearing:
- Modify section 10490 (c) relating to the point at which a person will no longer be regarded as a "scrutinized company" to include when the person files an amended or corrective filing with the SEC that corrects the specified violation(s).
 - Clarify that the prohibition applies to state contracts relating to information technology and communication contracts.

In addition, the committee may wish to include direction to the DGS to include procedures for implementing this measure within the State Administrative Manual and the State Contracting Manual in order to ensure the measure is implemented in a cost-effective manner. The SEC will have a public list of companies that have been found to be in violation of the DRC Act and that a final judgment, settlement or administrative action has been brought by the SEC. State contracting staff will need to be directed on how to quickly access that information and check on whether the company has subsequently remedied or cured the violation.

- 8) Related Legislation: The following is a list of related legislation:
- a) SB 1231 (Corbett) – Sweatfree Procurement Policy: This bill would have enacted various substantive and clarifying changes to existing provisions of the Public Contract Code (Section 6108) related to the "sweatfree" procurement policy and code of conduct. Status: The bill was vetoed by the Governor, 2010.
 - b) SB 657 (Steinberg) - California Transparency in Supply Chains Act of 2010: This bill requires, beginning January 1, 2012, retail sellers and manufacturers doing business in the state to disclose their efforts to eradicate slavery and human trafficking from their direct supply chains for goods offered for sale in the state. Status: Signed by the Governor, Chapter 657, Statutes of 2010.
 - c) AB 1650 (Feuer) – Procurement Prohibition on Iran Energy Section Related Companies: This bill prohibits persons engaging in investment activities in Iran's energy sector, as

specified, from bidding or entering into contracts with a public entity for goods or services. Status: Signed by the Governor, Chapter 573, Statutes of 2010.

- d) AB 498 (Hernández) – Procurement Disclosure for Sudan Related Companies: This bill requires a company that bids or submits a proposal for a contract for goods and services with a state agency to self-certify that it is not a scrutinized company engaged in specified activities in Sudan. Status: The bill was signed by the Governor, Chapter 272, Statutes of 2008.
- e) AB 1089 (Hernández) – Procurement Prohibition on Sudan Related Companies: This bill would have required DGS to identify a list of companies that the state has, or could have, a contract with that also conducts business operations in Sudan. Also, would have prohibited state agencies from entering into contracts with such companies. Status: The bill was held in Senate Appropriations Committee, 2008.

REGISTERED SUPPORT / OPPOSITION:

Support

The International Corporate Accountability Roundtable (sponsor)

Enough! (sponsor)

Amnesty International

Boston Common Asset Management

California Province of the Society of Jesus

Calvert Asset Management

Catholic Health East

Christian Brothers Investment Services

Congregation of Sisters of St. Agnes, Fond du Lac, WI

Dominican Sisters of San Rafael

EarthRights International

Global Witness

Human Rights First

Human Rights Watch

Individual, Starr King School for Ministry

Interfaith Center on Corporate Social Responsibility

Investor Environmental Health Network

Marianist Province of U.S.

Midwest Coalition for Responsible Investment

Midwest Coalition for Responsible Investment

PaxWorld Management LLC

Responsible Sourcing Network

Sister of the Holy Family

Sisters of St. Francis of Philadelphia

Sisters of St. Joseph of Springfield, MA

Social Responsibility Coordinator JOLT

Spring Water Asset Management

The Social Equity Group

The Sustainable Group at Loring, Wolcott & Coolidge

Trillium Asset Management

Tri-State Coalition for Responsible Investment
US Social Investment Forum
Zevin Asset Management, LLC
The International Corporate Accountability Roundtable (sponsor)
Enough! (sponsor)
Amnesty International
Boston Common Asset Management
California Province of the Society of Jesus
Calvert Asset Management
Catholic Health East
Christian Brothers Investment Services
Congregation of Sisters of St. Agnes, Fond du Lac, WI
Dominican Sisters of San Rafael
EarthRights International
Global Witness
Human Rights First
Human Rights Watch
Individual, Starr King School for Ministry
Interfaith Center on Corporate Social Responsibility
Investor Environmental Health Network
Marianist Province of U.S.
Midwest Coalition for Responsible Investment
Midwest Coalition for Responsible Investment
PaxWorld Management LLC
Responsible Sourcing Network
Sister of the Holy Family
Sisters of St. Francis of Philadelphia
Sisters of St. Joseph of Springfield, MA
Social Responsibility Coordinator JOLT
Spring Water Asset Management
The Social Equity Group
The Sustainable Group at Loring, Wolcott & Coolidge
Trillium Asset Management
Tri-State Coalition for Responsible Investment
US Social Investment Forum
Zevin Asset Management, LLC

Opposition

None known

Analysis Prepared by: Toni Symonds / J., E.D. & E. / (916) 319-2090