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## **Mandatory Due Diligence as a part of the Smart Mix of EU Measures to tackle Deforestation and Human Rights Issues**

### Sommario

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## 1. Introduction

COCERAL, FEDIOL and FEFAC agree on the need for the EU to take a leading role in the global fight against deforestation. EU actions can provide an important contribution towards reducing or halting deforestation, provided a comprehensive set of smart tools is set up and it is acknowledged that no one-size-fits-all approach will work across all commodities. The way we design the different requirements and how those will either support or hamper the EU engagement with producer countries will be critical to avoid or mitigate unintended consequences. It can only work hand in hand with building partnerships with producer countries and company engagement on the ground with farmers, local communities and authorities.

In order to effectively tackle global deforestation, the EU’s toolbox should be based on the use of a clearly defined due diligence system which this paper helps design further.

## 2. Due diligence regulatory framework

We support a harmonised mandatory due diligence system based on key process requirements, built on existing authoritative guidelines, notably the UNGP and OECD guidelines for multinational enterprises and responsible business conduct and the OECD/FAO Guidance for responsible agricultural supply chains according to which:

*Due diligence is understood as the process through which enterprises can identify, assess, mitigate, prevent and account for how they address the actual and potential adverse impacts of their activities as an integral part of business decision-making and risk management systems. It concerns adverse impacts caused or contributed to by enterprises as well as those adverse impacts that are directly linked to their operations, products or services through a business relationship.*

In the current debate on EU due diligence, a distinction is made between:

- a **horizontal due diligence or duty of care** (labelled “Sustainable Corporate Governance” under the Green Deal) derived from the sustainable corporate governance legislation, targeting companies and applied to all private and public commercial actors (point 3);
- a **vertical approach** to due diligence (labelled “Deforestation – Reducing the impact of products placed on the EU market” under the Green Deal) targeting products and applied across sectors and with sector-specific guidance, specific to Forest Risk Commodities (FRC) (point 4).

In the case of palm oil and soy supply chains, a due diligence framework should take into consideration existing voluntary initiatives by the private sector and provide a reasonable implementation phase, in order to enable adaptation of various business models to the new rules. In this way, the specific (FRC) guidance can corroborate the horizontal due diligence legislation.

Legislation should also be accompanied by a clear strategy to create an **enabling environment in origin countries**. This should include the setting up and enforcement of a legal and operational framework in producer countries, allowing continuous improvement, to identify and tackle the obstacles encountered along the supply chain, providing re-entry criteria and including incentives for operators willing to implement sustainable practices.

### 3. Horizontal due diligence requirements

#### 3.1 Scope of due diligence obligation

An EU legislation obliging commercial actors to carry out due diligence should be seen as **a means to mainstream supply chain transformation**, rather than in isolation from other mechanisms, because on its own it will not be transformative at scale.

Many of our companies involved in the soy and palm oil supply chain are already voluntarily implementing a (horizontal) due diligence. Making the implementation of such tool mandatory would not only enhance the level playing field across European companies, but also increase awareness among all supply chain actors about the importance of higher transparency and about the need to put in place appropriate sourcing strategies with the objective of demonstrating constant improvement (with potentially less temptation to sell to a leakage market). It would also provide room for engaging with farming communities and incentivising them towards more responsible practices.

The EU **due diligence process** should be risk-based and should, as in the OECD/FAO guidelines and UN Guiding Principles, require companies to implement several steps along their supply chain.<sup>i</sup>

Risk assessment should be an ongoing process supporting continuous improvement and acknowledging that, despite proven engagement and effort, it may not be possible to discover and prevent all impacts.

In line with the Non-Financial Reporting Directive (NFRD), the EU framework should offer standardised processes for evaluation and define the information that should be reported by companies.

The duty of due diligence should imply that operators take all necessary measures to respect and ensure the protection of human rights, natural forests and ecosystems, including all types of business relationships (i.e. suppliers, contractors, transport companies) in the upstream part of their value chain. A company cannot take responsibility for the behaviour of customers or clients downstream in the supply chain.

The **obligation set on companies** to carry out due diligence should be applicable to any business operating in the EU supply chain. Operators should carry out value chain due diligence which is proportionate and commensurate to their specific circumstances, the size of their undertaking, their capacity and resources, impact and ability to influence change in the value chain. This could avoid excessive burden for smaller actors, in particular SMEs.

A mandatory (horizontal) due diligence legislation needs to set **responsibilities** and describe clearly what is expected from players concerned across the supply chain. The legislation should distinguish between the company responsibility for carrying out the steps of due diligence and the responsibility for harm caused.

- The process of due diligence should encompass risk assessment of suppliers linked to the company's sourcing of products and services beyond their Tier 1 up to the origin of the raw material.
- A company should be responsible only for harm caused by its own direct operations on the ground or the operations of undertakings under its control, as companies do not have direct control over the governance of producing countries nor over the actions of indirect suppliers.

As such, a company should be expected to take appropriate action depending on whether it has caused, has contributed or is linked to an impact. For example, if a company:

- has caused an impact, it should be expected to mitigate the impact and remediate any harm if the impact has occurred.
- has contributed to an impact, it should mitigate its own contribution to the impact and should also contribute to remediating the harm to the extent of its contribution.
- has operations or products linked to an impact through a business relationship, it should use its leverage to prevent or mitigate such impact.

As not all impacts are equal, it should be possible to **rank risks according to the severity** of the impact and the likelihood of occurrence. Following the UNGPs, high risk is something that has high impact or high likelihood, whereas a lower risk may have a less significant impact or have lower probability of happening. A risk assessment should narrow down the possible risks to those that are the most likely and the most serious.

Solutions should be considered to **avoid duplication of due diligence steps and processes**, when there is overlap of risk assessments across the supply chain. It should be avoided that players circumvent their due diligence duties, but at the same time that excessive paperwork is triggered, especially for first importers.

The **use of product from certification systems** that respond to a number of agreed criteria could allow smaller players, with little or no capacity to carry out due diligence, to use certification as a proxy for enhanced chain transparency and no-deforestation and social claims. Whereas we understand that voluntary certification is not a silver bullet, the positive impact this has achieved in different supply chains justifies its complementary use in the context of the implementation of due diligence.

### 3.2 Criteria and definitions

The legislative framework should provide clarity on the **key definitions** and guidance, to assess possible adverse impacts. Due diligence should cover environmental and social risks across a company's operations and supply chains and make use of existing, generally recognised work.

- Environmental risks: deforestation, forest degradation, conversion or degradation of ecosystems, contamination, water.
- Social risks: human rights and social justice issues, labour and gender rights (child labour, forced labour), indigenous communities and land rights, Free, Prior and Informed Consent, inclusion of smallholder producers.

Due diligence requirements should put emphasis on legal compliance with existing local environmental and human rights laws, and provide clear guidance on the achievement of objectives going beyond local legal requirements.

In this sense, local enforcement of existing legislation in origin countries is critical to creating positive change on the ground. To achieve this, a stronger advocacy from the EU is needed, so as to ensure third countries fulfil their "duty to protect" by implementing and enforcing relevant laws and policies.

The implementation of horizontal mandatory due diligence requirements should be supported with appropriate definitions and guidance.

### 3.3 Enforcement of EU due diligence obligations

An EU regulatory framework introducing a mandatory due diligence would need to be complemented with a **proportionate and effective set of enforcement rules**, but it should also help stimulate companies to carry out due diligence across the full scope of their activities and value chains, and be transparent about their progress and the challenges they face.

Supervision by a **competent authority** identified at national level is more suitable to provide a balanced and objective approach across the EU than a judicial enforcement following claims initiated by stakeholders. Hence, we are in favour of a uniformed enforcement mechanism at EU level to guarantee the same level of treatment when it comes to the implementation of companies' due diligence strategies. In order to ensure consistency in the supervision of market players active in several Member States, the respective enforcement of national efforts should be coordinated at EU level. Businesses prioritising their due diligence efforts should do so based on the severity of the actual or potential harm to people and to the environment, which the legislation should allow for.

If the legislation were to include **liability for current and future harms**, it should be underlined that the OECD advises basing civil liability on:

- a) the foreseeability of the harm,
- b) whether there is a causal link between the business and the harm, and
- c) whether there were effective safeguards to prevent.

These forms of civil liability should be limited to severe harms caused by the company's own activities or activities of controlled companies, which could have been prevented or addressed with an appropriate due diligence in place.

Legislation should specify the importance of **meaningful stakeholder engagement** in carrying out due diligence. As part of the due diligence process, ongoing engagement and dialogue between a company and its stakeholders allow the company to understand and respond to their interests and concerns.

## 4. Possible "no-deforestation" marketing obligation

### 4.1 Designing minimum requirements - paying attention to undesired consequences

We acknowledge the intention to promote, further to the mandatory (horizontal) due diligence obligation applying to companies, a vertical regulatory approach specific to Forest Risk Commodities (FRC). The initiative would build on an enhanced EU Timber Regulation to possibly introduce a mandatory no-deforestation marketing requirement for FRCs and their derivatives. The objective would be to minimise the EU's contribution to deforestation and forest degradation worldwide, while diminishing the risk that commodities associated to deforestation be placed on the EU market.

COCERAL, FEDIOL and FEFAC are committed to ensuring their sourcing of commodities is not associated with environmental risks, in particular deforestation or conversion of natural habitat. We consider that **enforcing a deforestation-free obligation through an EU marketing prohibition would not be effective in addressing the complex problems that contribute to deforestation on the ground.** It would simply risk cutting off from a virtuous development path whole parts of the supply chain that are not yet meeting those requirements.

If such a vertical legislation were to introduce standards or minimum requirements, it is important that the EU legislation clearly define what is expected from operators, including what minimum requirements should be complied with and by when. Similarly important would be to prevent or mitigate unintended consequences through accompanying measures, gradual implementation, biome or landscape specific adjustments.

**1. With a scope extending beyond the principle of legality in producer countries, definitions related to “no-deforestation” supply chains should follow the approach taken by the Accountability Framework Initiative, FAO or High Conservation Value / High Carbon Stock approach (HCV-HCS).**

Deforestation should not only be considered as deforestation of primary forest but should include the concept of land conversion.

**2. If there was an obligation to meet a “no-deforestation” criterion, it should apply to all products and their derivatives put on the EU market.**

The focus on a limited number of products would bear the risk of diversion to circumvent or avoid the consequences of non-compliance. Specifications would have to encompass all derivatives of the same commodity identified at HS/CN code level. In order to avoid leakage effect, it is important that obligations be applicable to the products derived from the targeted commodities, which are likely to include soy and palm oil.

**3. Companies would need realistic reference dates, defining the period from which no-deforestation criteria should apply.**

Cut-off dates are sensitive and their setting should require a careful assessment so as to prevent or mitigate unintended consequences. A cut-off date set in the past would not be helpful in steering change in production practices. It would merely freeze the situation, allowing the EU to source only from existing no-deforestation areas, with no real impact on reducing deforestation elsewhere, while we need to allow public authorities and the private sector to continue engaging with other players and get more buy-in from both public and private actors. The differences in advancement of existing supply chains may justify different reference dates by sector (including taking into account biome-specific conditions) in order to define compliance with specific criteria or commitments as from a given date.

**4. Implementing a “no-deforestation” criterion would require built-in steps or gradual enforcement objectives.**

Not all forest-risk commodities have seen comparable efforts of sustainable supply chain transformation in all biomes. A gradual approach would be critical to allow continuing to lead engagement in partnership with producer countries, rather than pushing players to disengaging from higher risk areas. It would also incentivise economic operators in producer countries to sustain their effort of supply chain transformation and would allow providing appropriate responses to socio-economic drivers of deforestation. Likewise, re-entry criteria with recovery plans should be foreseen for operators to recover their past harm.

**5. Penalties or liabilities for EU operators' non-compliance with such criterion should take into account the complexity of supply chains and operators' active engagement and progress over time in changing production practices towards no-deforestation objectives.**

Setting stringent liabilities for companies not meeting the no-deforestation marketing obligation would hamper the engagement with producer countries and act as a deterrent to company involvement in higher risk areas.

As part of a "smart mix" and for these measures to be effective, it is important for the EU to support (small) producers and origin countries in their efforts to achieve inclusive and sustainable development and to incentivise producers in the implementation of sustainable practices. Very little attention has been given to the impact of a mandatory no-deforestation requirement on existing chains of custody (book and claim, mass balance, area mass balance, segregation, etc), whereas the nature of the obligation could lead to cutting off small players from their only market.

#### 4.2 Possible other policy options under scrutiny

Different policy options are being considered by the Commission further to the mandatory due diligence associated with a no-deforestation marketing requirement for forest-risk commodities commented under 4.1. The policy options would include other tools to support operators.

- In case the Commission opted for the **classification of producer countries through benchmarking or country carding** associated to a due diligence marketing obligation, we would consider imperative for sub-national situations to be taken into account and to make sure that 'good' operators in high-risk areas are not excluded. In addition, there should be a possibility for countries or regions that get a negative rating, to redeem compliance and re-enter the system, otherwise no positive development would be possible.
- The option of **a mandatory public certification** associated to due diligence marketing obligation risks becoming excessively burdensome for all players, in terms of costs and applicability. If existing certification systems could be recognised, even under strict criteria, this would acknowledge their role in the process since they have considerably contributed to driving change through our supply chains. While, if the intention is to set up a new EU certification system, this would deliver a negative message to all those farmers that have been improving their practices through compliance with voluntary certification systems.
- The option to introduce a **mandatory labelling obligation** applying jointly with the due diligence but with no marketing obligation would be the least effective. It would have limited positive impact in terms of environmental benefits, whether in producer countries or on the EU market and could even be misleading to consumers when applied to multi-ingredients products. It would bear important constraints though to ensure relevant information is transferred across the supply chain to support environmental claims.
- The **no-deforestation requirement associated with a benchmarking** or a country carding would prove least effective for a further engagement of the EU with producer countries and ultimately may have limited impact on global deforestation. It could prove disruptive for EU supplies.

## 5. Conclusion

We consider that setting up a mandatory horizontal due diligence obligation for all commercial actors in the supply chain should be seen as a means to mainstream supply

chain transformation. However, it should not be seen in isolation from other mechanisms or tools (as on its own it will not be transformative at scale) but rather as part of a smart mix of instruments that can be more effective in achieving sustainable transformation.

The EU due diligence framework should be risk-based, following guidance of existing international standards like OECD and UNGPs. Risk assessments should be an ongoing procedure supporting continuous improvement of the process and of the mitigation and prevention of harms that own operations may cause, contribute or be linked to. They should help acknowledge that, despite proven engagement and effort, it may not be possible to identify and prevent all impacts. This should be reflected in the proportionate and effective enforcement rules that have to be set up and in liabilities for non-compliance of certain obligations.

COCERAL, FEDIOL and FEFAC are not in favour of linking a due diligence obligation with the setting of a unilateral standard for forest-risk commodities (i.e. no-deforestation criteria), because this would work as a negative signal to the engagement with producer countries and act as a deterrent to company involvement in higher risk areas. Hence, if the implementation of mandatory due diligence were to be linked to compliance with a standard or minimum requirements, we strongly recommend to envisage built-in steps or gradual enforcement objectives agreed at supply chain level. This would be critical to continue leading engagement and partnership with producer countries. It would also incentivise economic operators in producer countries to sustain their efforts of supply chain transformation and allow to provide appropriate responses to socio-economic drivers of deforestation.

Whereas it would seem appropriate to combine a due diligence obligation with another tool, to help operators meet their requirements, the detailed provisions of the policy options will determine their positive or detrimental impact. All options will have considerable implications on logistics, costs and existing chains of custody and in turn on some weaker players in the chain. Their impact on actual deforestation, if designed as market prohibition for past deforestation decisions or without any flexibility to take into account specific situations (biomes, smallholders), risks being limited. Their design should hence not be guided only by the objective of cleaning up the EU supply chain, but should aim for supporting the fight against deforestation.

Considering that one of the main environmental objectives is to protect natural habitats and their importance on climate, carbon dynamics and biodiversity, the due diligence process should allow compensation mechanisms for areas that produce while protecting the environmental assets. Such natural capital approach shall be considered in all regions, giving the chance for areas with no natural habitats in place to be restored and then have access to compensation mechanisms to be defined.

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## **<sup>i</sup> ANNEX – OECD Due Diligence Steps**

- I. The first step should include the adoption of a company policy for responsible business conduct that establish strong enterprise management systems for responsible agricultural supply chains;*
- II. The second step should require companies to have traceability in place with sufficient knowledge of the origins of the goods sourced to ascertain risk or gaps. The legislation needs to allow to prioritise the engagement towards addressing those gaps. Companies should identify the full extent of actual and potential adverse impacts in the supply chain that they caused, contributed to or that are linked to their operations, products or services by a business relationship. This would require identifying the various actors involved, including, when relevant, the names of immediate suppliers and business partners and the sites of operations.*

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- III. *The third step should entail the design and implementation of a strategy to respond to identified risks. This means integrating and acting on the findings, including by preventing, mitigating and remediating impacts as appropriate. Where it is proven they have caused or contributed to adverse impacts, companies implementing due diligence would need to provide for recovery plans which should include actions for remediation. There should be a mechanism allowing players to come back into the supply chain, either after significant compensation for the harm caused, or through conservation elsewhere to a similar extent. The absence of a remediation mechanism risks being insufficiently inclusive and miss out on stimulating transformation. Where companies are linked to adverse effects, they should make use of their leverage to change identified bad practices.*
- IV. *The fourth step is about verifying supply chain due diligence and companies should take steps to verify that their due diligence practices are effective and that risks have been adequately identified and mitigated or prevented. If the risk has not been mitigated or prevented, the verification process should identify the reasons and new risk assessment should be undertaken.*
- V. *The fifth step of due diligence should require companies to transparently report on their exposure to human rights, natural forests and ecosystems risks, through their supply chains. The legislation should provide requirements to allow implementation of a standardised reporting, acknowledging that there may be local legal restrictions to full transparency. Companies would need to report on their progress at least annually, regardless of how much or how little progress has been made. This should be quantitative, clearly indicating the proportion of their volumes which are compliant with their commitments, and should be independently verified. Standardised public reporting (in line with the Non-Financial Reporting Directive) would make sure that information on progress is comparable across companies and can be used to monitor progress. Specific guidance could be provided for assurance and verification, as well as access to and use of satellite/radar monitoring platforms to ensure common datasets.*