

EU SUPPLY CHAIN REGULATION CAN MAKE SUSTAINABLE CONSUMPTION EASIER

Statement by the Federation of German Consumer Organisations (Verbraucherzentrale Bundesverband e.V. – vzbv) on the European Commission's proposal for a Directive on corporate due diligence sustainability and amending Directive (EU) 2019/1937

(Corporate Sustainability Due Diligence, CSDD)

27/07/2022

CONSUMERS BENEFIT FROM STRONG SUPPLY CHAIN REGULATION AND CORPORATE DUE DILIGENCE

A large majority of consumers would like to consume more sustainably. The sustainability properties of products and services are credence goods, i.e., properties that are not immediately visible and tangible. Consumers must therefore be able to trust that products have been manufactured in a sustainable, socially and ecologically just manner.

A representative survey commissioned by vzbv shows that a clear majority of consumers would like to see supply chains strongly regulated. More than 80 percent believe that textile companies, for example, should be liable for human rights violations and environmental destruction in supply chains. 85 percent of respondents agree with the statement that policy-makers should require all textile companies to respect human rights in the global supply chain.¹

Sustainable consumption starts at the beginning of the supply chain with socially and environmentally sustainable production conditions. The prerequisite for this is that all companies take responsibility for their entire supply chains. If companies produce in an unsocial and unecological way, consumers cannot rectify production shortcomings with their purchases. Ambitious supply chain regulation would ensure a minimum European standard for sustainable production.

vzbv welcomes the fact that the European Commission's proposal for a Directive on corporate due diligence sustainability (CSDD) contains civil liability rules that increase the chances of success for civil claims by affected parties, i.e. workers in the production countries vis-à-vis Western clients, before courts in EU Member States. This will allow affected parties to take legal action against the companies for damages. However, without improved procedural rules, such as a shift in the burden of proof, the hurdles will remain insurmountable for many of those affected.

¹ Federation of German Consumer Organizations, Kantar GmbH, Consumer Survey on Corporate Responsibility in Supply Chains – Results of a Representative Population Survey May 2021. Survey: Consumers for a strong supply chain law | Verbraucherzentrale Bundesverband (vzbv.de), 23/5/2022.

NEED FOR IMPROVEMENT IN THE CSDD

1. Extending the scope (Articles 2 and 3)

The European Commission's proposal foresees that only certain EU companies would fall under the scope of the CSDD. On the one hand, it covers companies with an average of more than 500 employees and annual turnover of more than 150 million euros. On the other hand, it covers EU companies with more than 250 employees and a turnover of 40 million euros if more than half the turnover in the completed financial year was generated in one or more high-risk sectors. Non-EU companies would be covered if they have an EU turnover of more than 150 million euros.

From vzbv's point of view, this restricts the scope too much and contradicts the guiding principles of the United Nations and the Organisation for Economic Cooperation and Development (OECD) for business and human rights, which in principle oblige all companies to exercise human rights due diligence, albeit to varying degrees and according, as appropriate. In vzbv's view, the question whether the scope is appropriate should be based primarily on the level of risk of the business activity. If the European Commission's proposal were adopted unchanged, not even one percent of European companies would be covered by it.²

The fact that – according to the proposal - companies only have to exercise due diligence if they cumulatively meet both criteria – number of employees and turnover – is problematic. This means that companies with high turnover and low staffing levels, such as in the financial sector, are left out in spite of the high risks involved in some cases.

vzbv calls for the following:

- ❖ The EU definition of large companies should be the basis of the scope of application³. This means that all companies with 250 or more employees or an annual turnover of 50 million euros or total assets of 43 million euros would be subject to the CSDD.
- ❖ In addition, it should suffice if just one of the two criteria (annual turnover or number of employees) is met.
- ❖ Moreover, all small and medium size enterprises listed on the stock exchange as well as small and medium size enterprises presenting a high-risk should fall within the scope, just as the European Parliament has proposed in 2021.⁴

2. The scope of due diligence obligations along the value chain should extend beyond "established", i.e. permanent, business relationships (Articles 1 and 3)

² Statistics Explained/ Eurostat's statistical information, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Structural_business_statistics_overview , 24/06/2022.

³ European Commission; 06/05/2003; Definition of micro, small and medium-sized enterprises. https://eur-lex.europa.eu/legal-content/DE/TXT/PDF/?uri=uriserv:OJ.L_.2003.124.01.0036.01.DEU 28/07/2022.

⁴ European Parliament, Resolution Proposal; Recommendations to the Commission on corporate due diligence and accountability; Texts Adopted – Corporate due diligence and accountability – Wednesday, 10 March 2021 (europa.eu), 28/07/2022.

The current limitation leaves a large part of supply chain relationships without rules, as a restriction to “established business relationships” would mean that all products largely sourced through exchanges, such as coffee, precious metals and other commodities, would fall outside due diligence requirements from the outset. The definition also does not address informal labour (workers operating without legally-binding employment contracts)⁵ and unofficial subcontracting, even though more than 60 percent of the global labour force works in the informal economy and it is well known⁶ that serious human rights violations often occur in this sector in particular.

In the same vein, it is insufficient that, according to the proposal, civil liability should only apply to established business relationships.

vzbv calls for:

- ❖ The limitation to “established” business relationships should be removed. Instead, policy-makers should introduce a risk-based approach that defines what is appropriate in terms of the scope of due diligence.

3. Industry initiatives and the role of audits and certifications (Article 7)

The CSDD proposal stipulates that companies have an obligation, among other things, to take appropriate measures to identify, prevent, end or at least mitigate negative impacts on human rights and the environment. They can obtain contractual assurances from business partners with whom they have a direct business relationship that they will comply with codes of conduct and/or prevention plans. Article 7 (4) states: “To verify compliance, the company may use appropriate industry initiatives or independent third party verification.” The European Commission defines industry initiatives (Article 3 j) as “a combination of voluntary procedures, instruments and mechanisms for fulfilling due diligence in the value chain, including verification by independent third parties, developed and monitored by governments, industry associations or groupings of interested organisations.” vzbv believes this means, among other things, private sustainability standard systems verified by certifications and audits, known to many consumers as “labels”.

In light of the fact that “industry initiatives”, i.e. voluntary sustainability standard systems and certifications, are not sufficiently regulated, vzbv is not in favour of this provision and calls for the regulation of the standard system and certification market before “industry initiatives” are allowed to play a role in legislation.

vzbv calls for the following:

- ❖ Certifiers need to meet legal requirements and preconditions when they engage in checking supply chains.⁷

⁵ The proportion of workers in non-registered and non-contractual employment has increased dramatically. For example, the International Labour Organization (ILO) estimates that around 2 billion people, or 61 percent of the global workforce, earn their living in the informal economy. ILO (2018): Women and Men in the Informal Economy: A Statistical Picture, 3rd Edition, http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/publication/wcms_626831.pdf

⁶ *ibid.*

⁷ For example, a number of (unannounced) on-site inspections per year, financial resources for certifiers, qualification requirements for auditors, anti-corruption requirements, etc.

- ❖ The introduction of a liability regime for certification companies that only allows certification umbrella organisations with a European registered office to provide transnational certification services, as only these can be subject to enforcement of EU authorities.⁸
- ❖ The definition of legal requirements for corporate due diligence that standard systems must meet before they can be used in due diligence certification.
- ❖ The expansion of the definition of "Independent third party review" Article 3 (h) to include mandatory government accreditation⁹ of the reviewing organisation.
- ❖ The use of "industry initiatives" in the performance of due diligence should not exempt companies from liability under the CSDD. Instead, measures taken under the industry initiative should always be reviewed for their appropriateness with respect to the specific human rights violation or environmental harm in question.¹⁰

4. Measures needed to strengthen enforcement

In Germany, the Federal Office for Economic Affairs and Export Control (Bundesamt für Wirtschaft und Ausfuhrkontrolle – BAFA) will in all likelihood be responsible for monitoring the proper implementation of companies' due diligence obligations arising from the existing national legal framework and from the CSDD (implementation of the present proposal). It was already entrusted with this task in the German Supply Chain Due Diligence Act (Lieferkettensorgfaltspflichtengesetz – LkSG). The German example shows how challenging a risk-based supervision is for authorities.¹¹

In vzbv's view, the certification through standard systems can only be an auxiliary instrument to support companies in fulfilling their due diligence obligations along their supply chains. The company itself needs to remain responsible and liable for its supply chain. At present, vzbv believes that standard systems and the certifications they provide still have too many systemic weaknesses to be used as part of the **official enforcement of supply chain regulation**. Problems include methodologically untestable and unambitious standard systems, certification processes that do not even consider due diligence requirements, flawed and deficient certifications, and systemic conflicts of interest among certifiers.¹²

⁸ The legal responsibility of certification companies is currently asymmetrical. This means that (German) companies have, on the one hand, clear contractual claims with regard to the service to be provided vis-à-vis the commissioned certification companies. On the other hand, certification companies have few concrete liability risks, which may be further reduced by enforcement problems, should workers in the production countries come to harm. Therefore, there is a need for a liability mechanism for certification companies.

⁹ Accreditation law is fully harmonised by Regulation (EC) No. 765/2008 on the principles of accreditation and market surveillance and under Decision No. 768/2008/EC on a common framework for the marketing of products.

¹⁰ Cf. OECD (2022), The role of sustainability initiatives in mandatory due diligence: Note for policy makers <https://mneguidelines.oecd.org/the-role-of-sustainability-initiatives-in-mandatory-due-diligence-note-for-policy-makers.pdf> pp. 10-11. Accessed 25/07/2022.

¹¹ Approximately 900 companies will fall within the scope of the LkSG from 2023 and 4,800 companies from 2024, which BAFA must inspect on a risk basis. At the beginning of 2022, BAFA commissioned the development of a testing mechanism and translation of the content of the legal requirements into testing requirements. The authority currently has 60 staff positions available for this purpose.

¹² vzbv's position paper "Voluntary standards and certifications need a legal framework" delves into the range of issues surrounding the official enforcement of corporate due diligence obligations.

A remedy could be government accreditation ("the auditing of auditors") according to Regulation (EC) No. 765/2008. It could **strengthen the quality and thus the credibility of standard systems and certifications**. In the case of state-accredited standard systems, the responsible Deutsche Akkreditierungsstelle GmbH, an entrusted authority under the supervision of the Federal Ministry for Economic Affairs and Climate Action (Bundesministerium für Wirtschaft und Klimaschutz – BMWK), would check whether the standard systems and their applied methodology are target-oriented and whether corporate due diligence is taken into account. Government accreditation for certification companies would mean that a state institution verifies that the certification company has the competence to examine global supply chains.

vzbv calls for the CSDD to:

- ❖ Facilitate and credibly safeguard enforcement of the rules by authorities.
- ❖ Oblige companies to provide publicly accessible information on their employee numbers and balance sheet totals so that interested parties can clearly see how many and which companies fall within the scope of the legislation.
- ❖ Provide for the exclusion from foreign trade promotion of companies that do not meet the requirements. This was also proposed, among other things, by the European Parliament in 2021 in its legislative initiative report on the subject.¹³
- ❖ Refer to Regulation (EC) No. 765/2008 on the principles of accreditation and market surveillance and require the adherence to the quality characteristics relevant therein in an accreditation of standard systems and certification companies.

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The Federation of German Consumer Organisations (Verbraucherzentrale Bundesverband) is registered in the German Lobby Register. You can find the respective entry here.

¹³ European Parliament, Resolution Proposal; Recommendations to the Commission on corporate due diligence and accountability; Texts Adopted – Corporate due diligence and accountability – Wednesday, 10 March 2021 (europa.eu), 28/07/2022.