

NAVIGATING SUSTAINABLE SUPPLY CHAIN POLICIES

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BACKGROUND

The idea of regulating corporate governance through legislation is not new in the EU. Legislation covering sustainable supply chains existed before this Commission came to power in 2019. Notable examples include the 2010 Timber Regulation and the 2017 Conflict Mineral Regulation. However, in the past decade, the impetus to regulate the sustainability of Europe's markets and businesses has grown significantly. It already showed in the commitments taken by the Juncker Commission with Communications such as the 2015 Circular Economy Plan or the 2018 Action Plan on Financing Sustainable Growth.

During the von der Leyen Commission, three different workstreams came together that gave rise to stronger regulations boosting the sustainability of European supply chains

The Green Deal is one of this Commission's cornerstones and it launched an ambitious sustainability agenda for the Union in 2019. This agenda for climate neutrality resulted in one of the largest regulatory efforts led by the Union, mostly by revising and amending key regulations and directives. Amongst this broad range of initiatives, several proposals issued by the Commission aimed at better instrumentalising due diligence practices to better the Union's supply chain.

The policy tools required to achieve these objectives were prepared by the Commission's DG JUST. It issued reports exploring policy options to set up an EU-wide framework for due diligence in 2019. These reports were put in motion by the Action Plan on Financing Sustainable Growth and resulted in the proposal for an EU wide-framework for due diligence requirements and risk management obligations.

While these policies are pursuing objectives that are deeply linked to the Single Market, they also have important international implications. Therefore, it is not surprising to see that the European trade policy also embraced these changes. In its 2021 Trade Policy Review, the Commission committed to lead actions and put forward proposals to make imports into the EU more sustainable and aligned with international environmental and human rights standards.

These different workstreams resulted in a rather homogenous corpus of policies targeting the sustainability of EU supply chains. This piece will deep-dive into a handful of policies to highlight the key issues that arose from them.

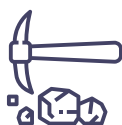


UNDERSTANDING THE COMMISSION'S APPROACH

Looking at a handful of proposals issued by the Commission will help us understand the approach it sets forward to make EU supply chains more sustainable. The initiatives listed below are all aiming at achieving similar policy objectives, including:

- answering citizens' demands for more sustainable goods,
- mitigating the adverse social and environmental impacts of the Union,
- embedding sustainability in businesses practices,
- preserving a level-playing field for European companies following high standards.

Conflict Mineral Regulation



Adopted in 2017, this regulation aims at addressing risks in the Union's conflict mineral supply chains. It provides specific due diligence requirements for importers of such minerals and is compatible with industry-led schemes.

Batteries Regulation

This proposal issued in 2020 stems from the EU Green Deal and aims at boosting this sector in Europe. Amongst the broad range of issues covered, articles 39 and 72 of this initiative provide due diligence and supply chain requirements for the sector.



Deforestation Regulation



This proposal issued in 2021 also stems from the EU Green Deal. It replaces the Union's framework for forestry products and relies on strong supply chain due diligence requirements to enforce a market ban on commodities related to deforestation.

Due Diligence Directive

This directive seeks to answer repeated demands from the Parliament by setting up a Union-wide framework for sustainable governance. It creates horizontal requirements for due diligence policies set-up by businesses, including financial entities.

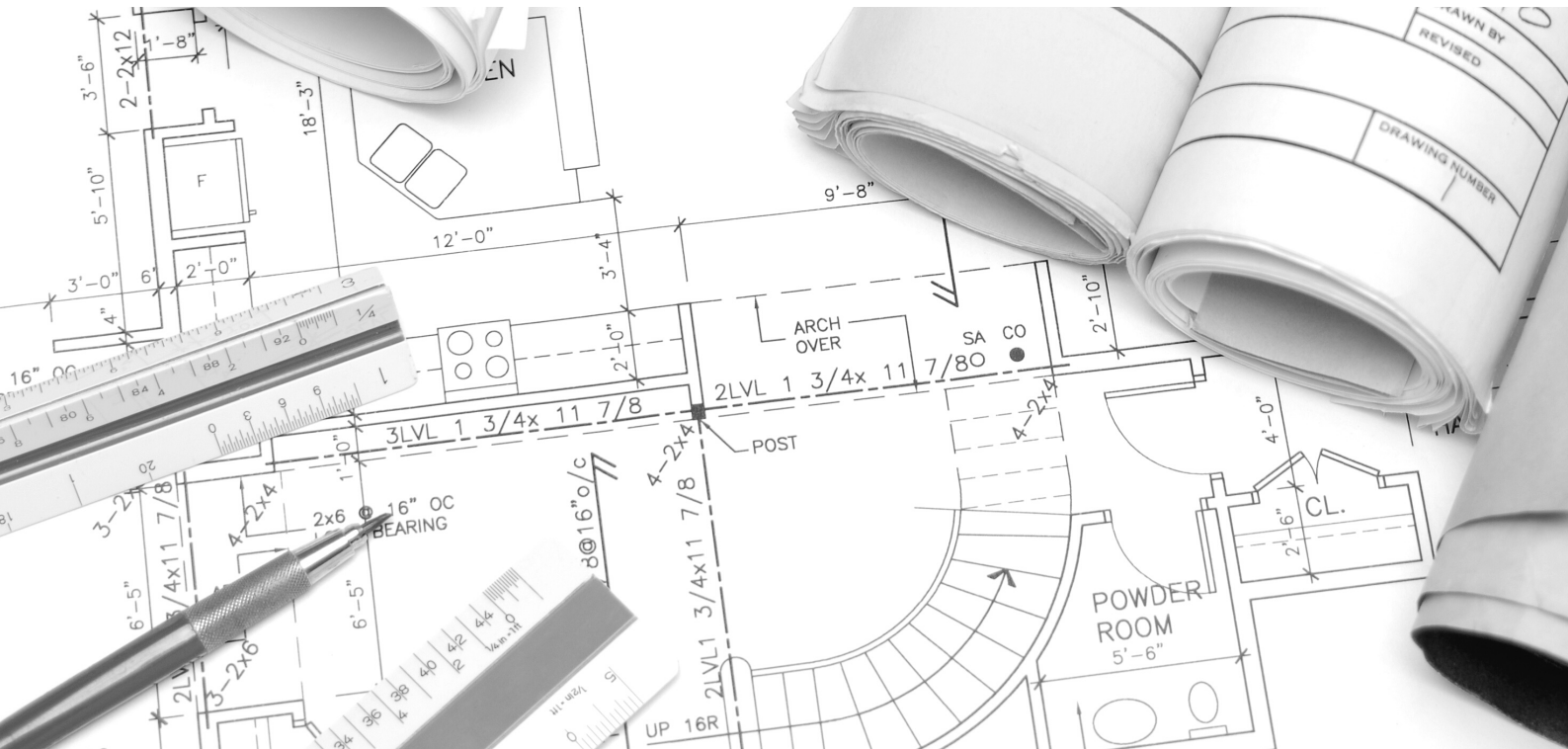
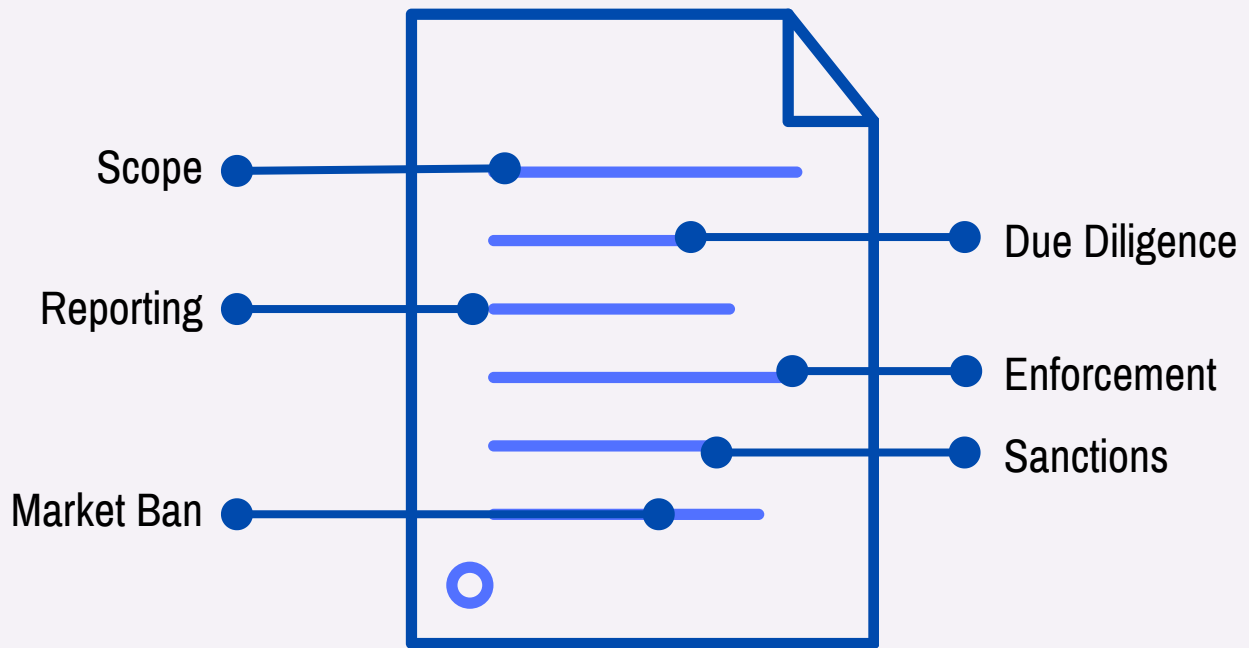


Forced labour instrument



The forced labour instrument aims at banning entry into the market of goods produced using forced labour. This ban is enforced by a risk-based investigation mechanism.

Sharing common policy objectives, these policies seem to also have been constructed by the Commission following a similar blueprint. In the next pages we will take a look at the key points you should consider when assessing such proposals.



Key issues in the scope & definitions

As you may be well aware, understanding the definitions laid down by a proposal and the scope of application is a key first step to assessing how a piece of legislation will impact your sector. Sustainable supply chain initiatives are no exceptions, so let's look at a number of key points that should grab your attention.

Operators: The definition of operators targeted by the requirements of a piece of legislation is a determinant for its application. Definitions that could otherwise seem quite trivial become cornerstones of the initiatives. One important distinction, for instance, is the one that separates operators 'placing on the market' and 'making available on the market'. The former often refers to the first time a good or commodity is placed on the market, while the latter can be applied to recycled or upcycled goods. Definitions can also seek to specify exactly the type of entities falling in the scope, especially in relation to the financial sector.

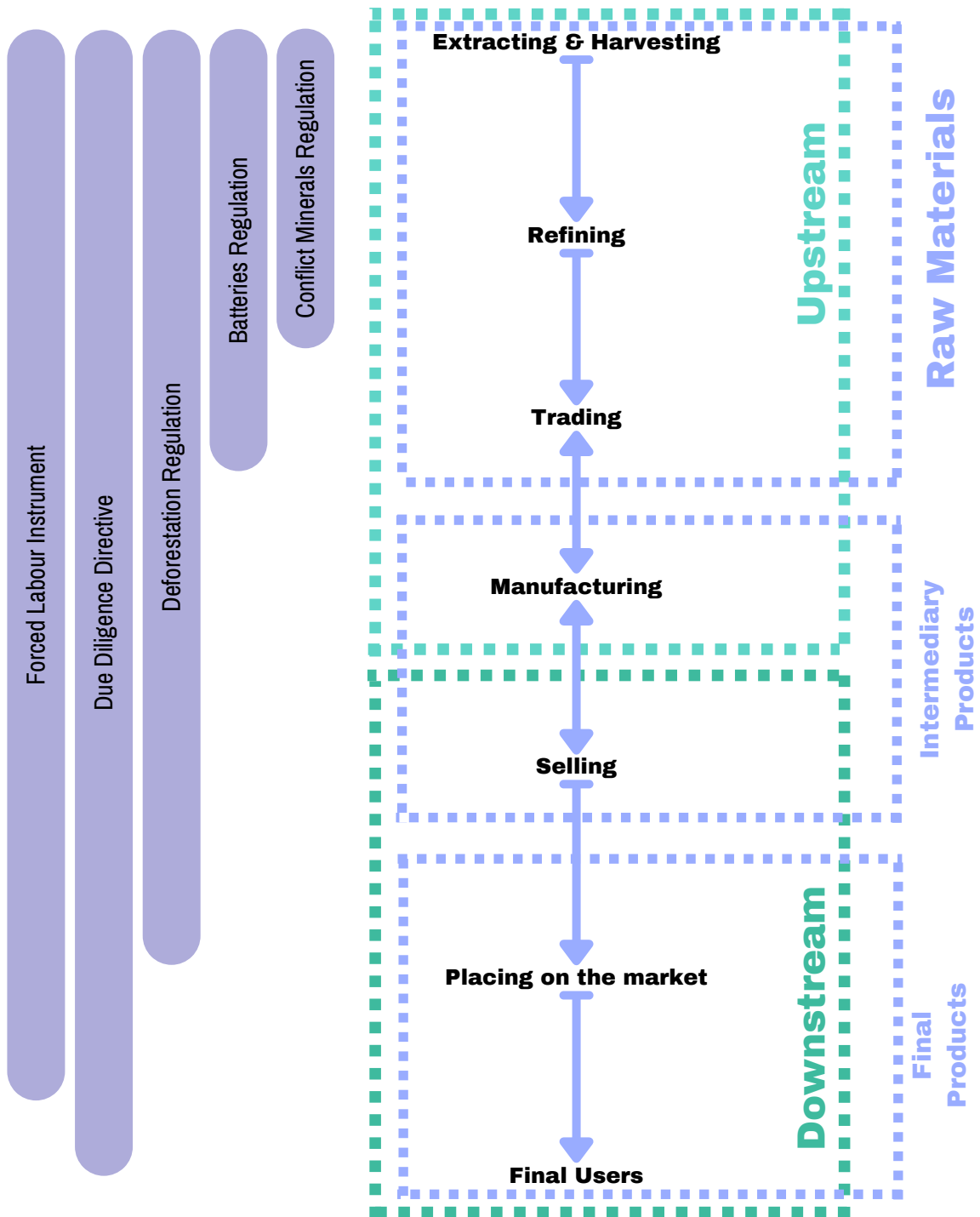
Supply chain: In spite of the number of initiatives targeting supply chains, the definition of the term is not uniform in EU legislation. The activities included in that definition can determine which part of the supply chain will be targeted by the initiative (e.g. sourcing, processing, trading, production activities, advertising...).

Other definitions: Some definitions are specific to each proposal but carry a lot of weight in determining their impact on businesses. For instance, the definition of 'established business relations' in the Due Diligence Directive can either limit or extend the scope of application of the text depending on its wording.

Product-specific scopes: Several of these initiatives are targeting specific products. This either results from the nature of the legislation (Batteries Directive) or from a risk-based approach (Conflict Mineral Regulation, Deforestation Regulation). In the case of the Deforestation Regulation, the list of commodities is designed to be reviewed and modified by the Commission through delegated acts which can result in important uncertainties for businesses.

Thresholds: Thresholds are another tool that the Commission can use to target the scope of an initiative. It is, for instance, used in the Due Diligence Directive to only apply requirements to companies exceeding a certain turnover and/or workforce. These thresholds can also be subjected to modification by delegated acts as is the case for the import thresholds set out by the Conflict Mineral Regulation.

Figure 1. Scope of supply chain activities



The scope of economic activities covered by due diligence requirements varies tremendously from one proposal to the next. It is adapted to the objective pursued by the proposal. The broader the reach, the more activities will be concerned, the more indirect impacts can be expected on actors involved in supply chains.

Table 1. Comparative table of EC proposals - Scope & Definitions

	Conflict Mineral Regulation	Battery Regulation	Deforestation Regulation	Due Diligence Directive	Forced Labour Regulation
Product Specific	Tin, Tantalum, Tungsten and Gold	Batteries	Cattle, Cocoa, Coffee, Palm, Wood	No	No
Risk based	Targets raw materials extracted in conflict zones	No	Targets commodities linked to deforestation and produced in specific areas	Lower thresholds for certain high-risk sectors	Investigations are based on the risks identified
Threshold based	Apply to certain import thresholds	No	No	Targets companies above certain turnovers or employee numbers	No
Operators Targeted	Placing on the market	Placing on the market	Placing on the market	All actors in the thresholds	Placing on the market
Scope can be changed by DEAs	Import thresholds can be adapted	To be reviewed by the Commission	Commodities list can be reviewed by the Commission	No	No

Key takeaways:

- These initiatives all mobilise different tools to set out a targeted scope.
- Targeted scopes ensure that the initiative balances the impact of the proposal with the obligations it creates for companies and institutions for the sake of policy efficiency.
- The ecosystem of supply chain proposals develops coherent approaches but each initiative is balanced using different tools to fit its specific requirements and objectives.

Understanding due diligence requirements

The industry did not wait for legislation to set up due diligence schemes aimed at improving their sustainability, accountability and transparency. However, this tool has been increasingly featured or strengthened in legislative initiatives to reach specific goals:

- to ensure that companies are sourcing raw materials sustainably (Conflict Mineral Regulation, Batteries Regulation)
- to inform and enforce a market ban (Deforestation Regulation, Forced Labour Regulation),
- to harmonise practices and associate clear responsibilities and liabilities with these practices (Due Diligence Directive).

Information collection: Several of these initiatives require targeted operators to collect information on their raw material input and the entity that supplied them. This feeds key information on the origins and traceability of products for risk assessment purposes. The Deforestation Regulation proposal has the most stringent set of requirements so far, going as far as requesting the geolocalisation of the harvesting sites.

Risk assessment, management and mitigation: These proposals aim at ensuring that companies have the necessary process and resources to identify and act upon environmental and social risks arising in their supply chains. Once again, the level of the requirement varies from one proposal to the next, with some sticking to the baseline OECD recommendations and others setting up an outright market ban for products associated with certain risks. Some proposals also provide for businesses to suspend or terminate their business relationships as the last resort measure.

Reporting: Reporting can refer to two separate channels in these proposals. The first refers to companies publicly communicating the outcome of their due diligence processes, hence anchoring transparency requirements in business practices. The recently adopted Corporate Sustainable Reporting Directive plays an important role in this space. The second refers to reporting on due diligence policies to EU institutions or other competent authorities, for instance, to support investigations and assessments.

Third-Party Verification: The proposals can include requirements for third-party verification, more commonly known as auditing. These are included to insert private sector enforcement in the different schemes and ensure that businesses are accountable to their due diligence policies. Audits can also be mobilised as ways to control suppliers, run field checks or support the uptake of best practices.

Grievance Mechanisms: This mechanism included in the proposals aims at boosting the accountability of businesses by ensuring that stakeholders with legitimate interests can raise their concerns to companies and possibly be compensated in cases of environmental or social risks. The initiatives can restrict or open access to these mechanisms by defining which stakeholders are legitimate (e.g. NGOs, trade unions, indigenous people...)

Liability: Attaching civil liability to due diligence obligations entails that businesses can be found responsible for damages caused by their supply chain activities if they failed to properly identify, assess and mitigate risks. This is another tool in the Commission’s arsenal to ensure that companies proactively eliminate risks in their supply chain.

Figure 2. Due diligence policies

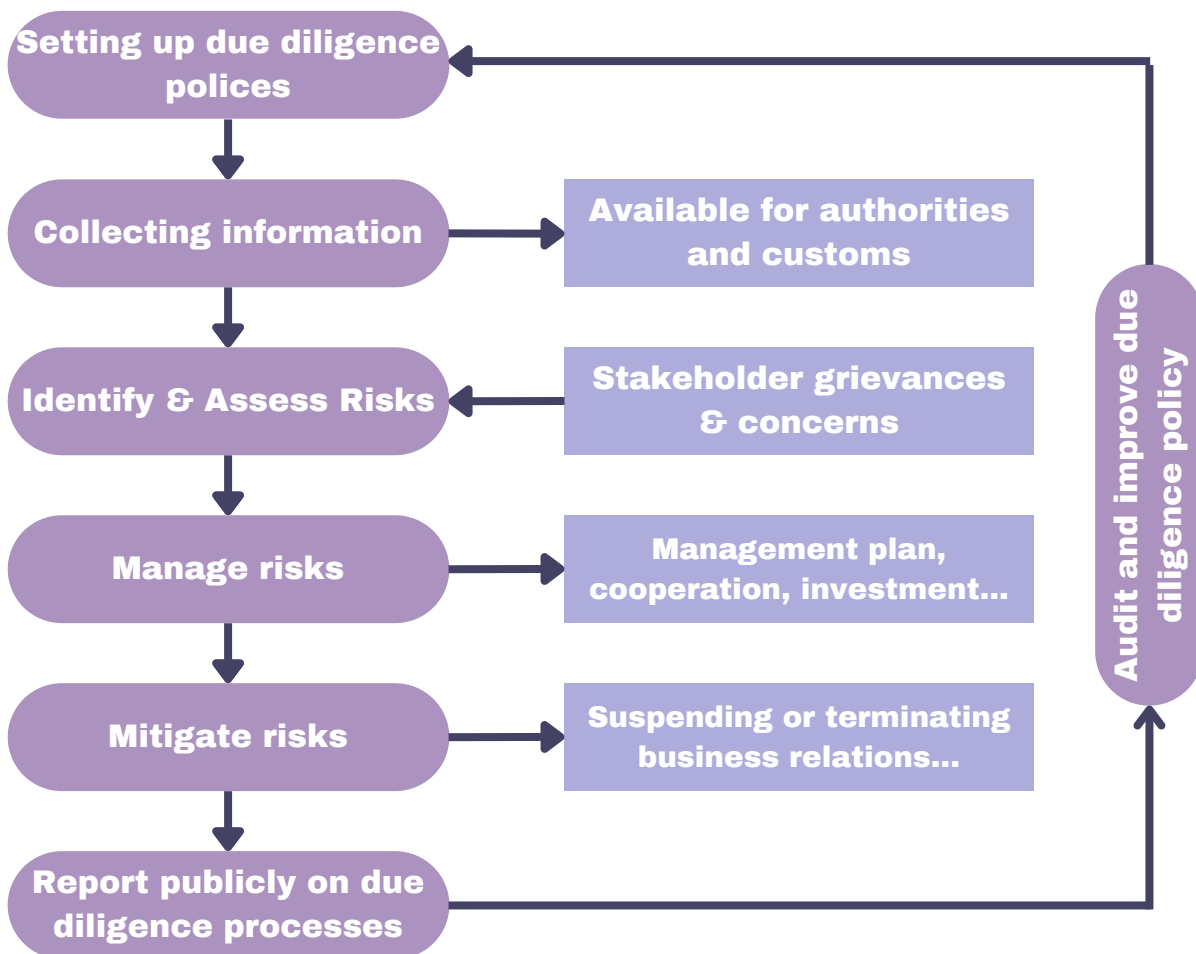


Table 2. Comparative table of EC proposals - Due diligence requirements

	Conflict Mineral Regulation	Battery Regulation	Deforestation Regulation	Due Diligence Directive	Forced Labour Regulation
Information collection	Basic information should be collected on raw materials, suppliers and traders	Follows OECD guidelines	Extensive information should be collected on commodities, and suppliers	Unspecified	Specific information should be made available for customs clearing purposes.
Risk management practices	Uses risk management plans, risk mitigation efforts, suspension of trade and disengagement.	Follows OECD guidelines	Unspecified	Includes prevention action plans, contractual assurance, investments, support for SMEs, financial compensation, temporary suspension of commercial relations and the termination of business relations	Taken into account in investigations as a mitigation factor.
Reporting	Public and institutional reporting	Public and institutional reporting	Public and institutional reporting	Public and institutional reporting	No
Third-party verifications	Due diligence practices should be checked by third-parties	Due diligence practices should be checked by third-parties	Third-party verification processes can be mobilised to improve processes	Third-party verification processes can be mobilised to improve processes	No
Grievance mechanisms	No	No	Substantiated concerns are acknowledged	Yes, establishes requirements for complaints procedures	Concerns can trigger investigations

Key takeaways:

- The setting up of due diligence policies can be an end in itself for initiatives or a stepping stone to enforce more stringent requirements such as a market ban.
- These requirements can vary a lot from one legislation to another and create a complex environment to navigate for actors operating under several frameworks.
- The requirements proposed by the Commission tend to be increasingly specific as time passes, sometimes moving beyond the OECD guidelines but remaining aligned with internationally agreed standards.



Enforcement, the devil in the details

Notwithstanding the Commission's initial intentions and the level of requirements set out in a proposal, the enforceability of the initiatives will determine their implementation. As for the previous sections, the Commission explored different tracks within a coherent policy framework across these initiatives.

Auditing: Third-party verification schemes enable independent bodies to assess the compliance of due diligence practices in relation to the legislative requirements. They are also able to provide recommendations to improve supply chain due diligence practices.

Licensing Scheme: Some initiatives empower the Commission to recognise supply chain due diligence schemes as equivalent to the legal requirements. This tool enables industry-led due diligence initiatives to contribute to the objectives set out by certain initiatives.

Competent Authorities: These initiatives will rely on authorities designated by Member States for their implementation. These bodies can be tasked with a variety of activities including compliance checks, customs controls, market surveillance or investigations.

Compliance Checks & Investigations: Competent authorities can be empowered to check or investigate the compliance of operators, commodities or goods with the requirements set out in the different frameworks. The processes can be more or less detailed and triggered on the basis of substantiated concerns.

Checks on Goods: The proposals aimed at enforcing a market ban required an effective control of goods. The controls can take place before goods are released for circulation based on due diligence documentation; or after they are placed on the markets on a risk-based approach.

Remedial Action: In cases of non-compliance, the relevant authority can be empowered to deliver notices of non-compliance demanding that the targeted operator takes remedial action.

Sanctions for goods: Goods and commodities that are found to be non-compliant with requirements can be confiscated, destroyed or donated. This prevents such goods from circulating on the market and creating added value.

Sanctions on entities: There is a variety of measures that can be applied to operators in cases of non-compliance. The sanctions are not necessarily spelt out by the text and can be defined by the Member States or authorities. The penalties used should respect principles of effectiveness, proportionality and dissuasion.

Table 2. Comparative table of EC proposals - Due diligence requirements

	Conflict Mineral Regulation	Battery Regulation	Deforestation Regulation	Due Diligence Directive	Forced Labour Regulation
Third-party verification	Schemes should be audited	Schemes should be audited	-	-	-
Licensing Schemes	Due diligence policies can be licensed by the Commission	Due diligence policies can be licensed by the Commission	-	-	-
Competent Authorities	Competent authorities designated by Member States	Market surveillance authorities	Competent authorities designated by Member States Specific duties for customs authorities	Supervisory authorities designated by Member States and coordinated in a European Network of Supervisory Authorities	Competent authorities designated by Member States lead investigations. Specific duties for customs authorities
Compliance Checks & Investigations	Ex-post checks are carried out on a risk-based approach.	Market surveillance authorities can assess non-compliance related to due diligence obligations	Competent authorities can check the compliance of due diligence policies based on risk analysis or substantiated concerns	Supervisory authorities can initiate investigations on their own-motion based on substantiated concerns to assess compliance	Competent authorities can initiate investigations based on substantiated concerns to check that operators apply the ban on forced labour use
Customs Checks	-	-	Customs authorities check the compliance of commodities based on due diligence declaration	-	Customs authorities access specific information to assess the compliance of goods and release them on the market
Notice of Remedial Action	Notice of non-compliance can lead to revoking the licensing of the scheme	Notice of non-compliance can be issued in relation to due diligence requirements	-	-	-
Sanctions & Fines	Competent authorities are able to impose penalties	Competent authorities can impose penalties in last resort	Penalties can include: fines, confiscation of goods, confiscation of revenues, suspension or prohibition of from public procurement	Sanctions to be defined by Member States in an effective, proportionate and disuasive manner	Competent authorities can adopt decisions to suspend trade, prohibit the placement on the market of goods or the withdrawal of goods



Our key takeaways:

- Soft enforcement measures include relying on third-party verification or licensing schemes to assess compliance.
- Checks and investigations constitute harder enforcement frameworks enabling institutions to sanction entities.
- Initiatives seeking to ban certain risks (e.g. deforestation or forced labour) rely on a stronger enforcement framework.
- The enforcement of supply chain policies is decentralised and delegated to a —more or less— coordinated network of national authorities.
- Strong sanctions are provisioned in the texts, however, certain proposals stress that they should only be used as last resort instruments.



CRUCIAL BALANCING EXERCISE IN THE PARLIAMENT

The Parliament has been instrumental in the development of this policy stream. In the past decade, MEPs have adopted several own-initiative reports demanding that the Commission propose initiatives on batteries, deforestation, forced labour and sustainable governance requirements. In spite of united calls for action, MEPs have supported different approaches when discussing these initiatives. Based on OPP's coverage of Parliament meetings, a number of horizontal issues arising across these debates can be outlined.

Administrative Burden: One of the Parliament's top priorities is to curb the bureaucracy and costs involved in the application of these new requirements. This is especially true for the right-hand side of the hemicycle which is keen to find solutions to ease the implementation of these initiatives for European businesses. This concern can be translated into amendments lowering the level of requirements or restricting the reach of the texts.

Guidelines & Support: This is another recurring demand that aims at simplifying the implementation of these proposals for companies. MEPs are asking the Commission or competent authorities to provide guidelines, as well as, technical or financial support to help businesses uptake new due diligence policies.

SME treatment: This concern is heavily related to the previous one as MEPs are keen to create a differentiated treatment for SMEs. This can include demands for lower standards to be set up for SMEs or the creation of additional financial support for these structures that are deemed to be more vulnerable to administrative burden.

Stakeholder Grievances: The inclusion of grievance mechanisms that can provide compensations for stakeholders affected negatively by EU supply chains is another consistent demand. This tends to stem more from the left-hand side of the hemicycle and focuses on ensuring that NGOs, trade unions, indigenous people and other civil society groups can flag risks to businesses or competent authorities.

Scope: Even after the publication of the text by the Commission, the scope of the initiatives remains an issue. This concerns all dimensions of the scope, both its width of the scope —the number of entities or products targeted, and its depth —the number of economic activities that are included. This is one of the most heavily debated issues in the Parliament. If we consider the Parliament's position on the Battery and Deforestation regulations, the balance seems to tip in favour of broader and deeper scopes.

International standards: MEPs appear keen to anchor these initiatives into internationally recognised standards specifying the definition of environmental and social risks. This leads to amendments expanding the standards proposed by the Commission.

Financial Institutions: Several political groups on the left-hand side of the hemicycle consider financial institutions to be the blindspot of these initiatives. They aim at bridging that gap by integrating these institutions into the text along with relevant requirements.

Risk-based Approach: Risk is a central concept for the functioning of these initiatives as it often underpins the scope or the enforcement of the mechanisms drawn up by the Commission. Numerous amendments are related to the functioning of risk-based tools or the sectors or commodities that should be considered as risky.

Faces of supply chains debates



Lara Wolters (S&D, NL)
EP JURI, IMCO & CONT
Lead rapporteur on the INL on Due Diligence & on the Due Diligence Directive

Leading on due diligence and responsible business conduct.



Raphaël Glucksmann (S&D, FR)
EP AFET, INTA & AFCO
Opinion rapporteur on the Due Diligence Directive

Heralding forced labour and human rights issues.



Anna Cavazzini (GR, DE)
EP IMCO & INTA
Rap. on deforestation and shadow on due diligence and batteries

Promoting ambitious requirements.



Axel Voss (EPP, DE)
EP JURI & LIBE
Shadow rapporteur on the INL on Due Diligence & on the Due Diligence Directive

Preventing bureaucracy & supporting SMEs.



Manon Aubry (Left, FR)
EP ECON, JURI & DEVE
ECON & ENVI shadow on due diligence

Advocate of stronger measures



Alexandr Vondra (ECR, CZ)
EP ENVI & LIBE
Shadow rapporteur on due diligence and batteries

Advocating against administrative burden



Pascal Durand (RE, FR)
EP JURI, AFCO & ECON
Lead rapporteur on the CSRD and shadow on the INL on Due Diligence





Balancing ambition and feasibility on due diligence.



Heidi Hautala (S&D, FR)
EP INTA, DROI & JURI
Shadow rapporteur on the Due Diligence Directive & Deforestation Regulation

Long EP track record on forestry and sustainability issues.

KEY DATES AHEAD

-  The **Batteries Regulation** is currently in the trilogue phase as the co-legislators approach the conclusion of this process.
-  The **Deforestation Regulation** is currently in the trilogue although the process appear to be experiencing delays.
-  The **Due Diligence Directive** is slowly making its way through the many EP committees involved in the process, while the Council muster its general approach.
-  The work on the **Forced Labour Instrument** should be initiated in the EP soon.


2022

● DECEMBER

Review of mandate in working group (tbc) 

● DECEMBER


 4th Trilogue (tbc)

General approach in Competitiveness
Council (tbc) 

 3rd Trilogue (tbc)

2023

● JANUARY

Adoption of opinions in EP DROI, EMPL,
AFET, DEVE, IMCO & INTA 

● FEBRUARY

Adoption of opinion in EP ENVI 

● MARCH

 Vote in Plenary (tbc)

 Adoption of report in EP JURI

 Vote in Plenary (tbc)

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