10 CHANGES NEEDED FOR THE EU'S CSDD TO HAVE AN IMPACT ON THE GROUND

The European Commission's proposal on Corporate Sustainability Due Diligence (CSDD) finally mandates that businesses respect human rights and the environment. However, in its current shape, the CSDD Directive will fail to reach its true potential. Due to loopholes, exclusionary criteria and an unambitious approach to supply chain coverage, the CSDD could end up having a limited impact where it is needed most. It will fail to improve the livelihoods of smallholder farmers, workers and miners at the beginning of our global supply chains.

If the EU wants to pave the way for a sustainable transition they will need to broaden the scope of due diligence in the Directive, address living income and living wage at all levels of the supply chain, and foster partnerships with producing countries.

Here are the 10 key changes needed to ensure that the Directive makes impact where it is needed most.

1. Make it applicable to the full supply chain, not only ' established business relations'

It may sound logical to limit the scope of due diligence efforts in the Directive to a company's "established business relationships": they are easier for companies to influence. However, this is not a logical approach. This new concept included in the proposal covers businesses' direct and indirect relationships, which are, or which are expected to be 'lasting' based on the 'intensity' or 'duration of the relationship', and which do not represent a "negligible or merely ancillary" part of the value chain.

As SHIFT, a non-profit organization specialized in the UN Guiding Principles on Business and Human Rights, rightly indicates, the Directive deploys "the novel and untested concept of 'established business relationships' (...) based on the ease for business of identifying risks and using leverage in these more proximate or strategic relationships". Yet, improvement is often more urgent among the further removed, less established or informal business relationships. The Directive thus risks leaving completely unattended the **severe negative impacts** on smallholder farmers, workers, miners and other often marginalized groups **at the beginning of the supply chains.** Moreover, women are overrepresented in less established relationships, such as in semi-formal and informal work, unofficial subcontracting, and home-based work at the lower tiers of value chains. This restrictive approach allows for a very small chance that companies will assess the kinds of relationships that can lead to severe human rights impacts for women.

This untested legal concept may also ultimately provide **an incentive to keep or shift to short-term business relationships.** For instance, it could lead to companies shopping around for suppliers as a way of avoiding falling into the scope of the obligation to conduct due diligence. Short-term business relationships and frequent shifts in the supplier base create uncertainty for suppliers and are not conducive to the type of relationships and investments necessary to make lasting improvements in sustainability. Thus, we urge policymakers to align this concept with the UN Guiding Principles on Business and Human Rights (UNGPs) and the OECD Guidelines for Multinational Enterprises (OECD Guidelines), where leverage is an important element for companies to use when addressing the impacts found in their supply chains, but is definitely not an element that should define the scope of their actions.

2. Focus due diligence where the most severe social and environmental impacts are

The UNGPs and the OECD Guidelines expect companies **to cover adverse impacts at any point of the supply chain.** Importantly, they recognize that it might not be feasible for a company to address all of them at once, and guide companies on how to approach this through the **prioritization of risks** based on the **severity and likelihood of the adverse impacts.**[1] Unfortunately, prioritization is not central to the CSDD; instead, the focus seems to be on adverse impacts that are easier for companies to identify and address based

1 OECD Due Diligence Guidance for Responsible Conduct, Due diligence can involve prioritization (risk-based). Pag. 17

on their leverage through the notion of established business relationships.

Limiting due diligence action to a company's direct suppliers means that businesses are free to ignore severe impacts at any other point in their value chain, unless it is among their established business relations. For example, in the palm oil value chain, due diligence is often focused on permanently contracted suppliers, while non-contracted independent smallholders are often ignored, despite the severity of negative impacts they face, such as a lack of access to a living income, and gender-based violence.
Our recommendation, again, is to align this approach with the UNGPs and the OECD Guidelines, and clearly differentiate between the scope of due diligence, leverage and the prioritization of risks. Companies should focus on the most severe risks wherever they can be found in the supply chain.

3. Require companies to work with their suppliers towards a Living Income & a Living Wage

To address sustainability issues, the CSDD directive should take full advantage of the **multiplier effect of poverty alleviation.** The reality is that, in the case of agribusiness value chains engaging smallholder agriculture, **the lack of access to living incomes for farmers may be the most salient sustainability risk.**[2] The CSDD proposal should make clear that poverty is a root cause of the sustainability issues in global value chains. A leaked draft mentioned this approach when discussing measures to take in cases of child labour: "Contributions to ending the child labour should include adjusting pricing practices to ensure a decent living of families and farmers, supporting to build schools and require the supplier to avoid child labour." Unfortunately, this essential element was removed from the final proposal.

The Directive should clearly state that purchasing practices, including pricing, should be assessed when companies are looking **at how their operations create or contribute to negative impacts in their supply chains.** In addition to this, companies need to be incentivized to **support and work collaboratively with their suppliers** to develop time-bound and measurable actions towards enabling access to living incomes and wages for the farmers and workers they source from. Guidance already prescribed in Art. 13 should further develop on how to do this proactively. According to the proposal, "due diligence should be carried out with respect to adverse human rights impact on protected persons resulting from the violation of one of the rights and prohibitions as enshrined in the international conventions as listed in the Annex". Currently, **the right to an adequate standard of living** is not listed in the Annex. **This needs to be addressed, because the right to an adequate standard of living** is a precondition for the realization of **all human rights** and provides a more solid foundation to progressively work towards global supply chains where **workers and farmers earn a living income.** Thus we recommend directly including it in the Annex to avoid that businesses overlook impacts on the interests protected by this right.

4. Include SMEs

The Directive introduces a corporate responsibility requirement that covers EU's larger companies, defined as having more than 500 employees and an annual turnover of €150 million. When a company is operating in a high impact sector (agriculture, textiles and minerals), this is lowered to 250 employees and a turnover of €40 million. This represents a very small amount of Europe's businesses, only 1% according to the proposal.[3]

The argument for this setup is that corporate sustainable due diligence is too complicated for smaller companies. From experience, we know this to be wrong. Solidaridad works with many small and medium-sized enterprises (SMEs) that are in fact leading the way on corporate responsibility. Across different sectors we see smaller companies forging partnerships and working towards sustainable solutions. SMEs are often more willing to adapt to more complex criteria than larger companies, as they usually have fewer suppliers and longer-term relationships.[4] In fact, this approach risks limiting the Directive's ability to create a level playing field that allows all corporate players to embrace due diligence without fear of unfair competition, a stated goal of CSDD in the first place. In addition, it complicates sector-broad approaches.

But this is not the only reason smaller companies should be in the scope of the proposal. The reality is that SMEs can also have severe impacts on the people and the planet; for example, in the extraction of construction minerals. According to the EC, SMEs are dominant in this sector. Both the UNGPs and OECD Guidelines recognize that although the size of an enterprise can affect the nature and extent of due diligence, **due diligence must be commensurate with the risk and not with the size of an enterprise.**

2 UN Global Compact (2021) Improving wages to advance decent work in Supply Chains. Available at: https://livingwages.unglobalcompact.org/

3 small and medium sized enterprises (SMEs) that include micro companies and overall account for around 99 % of all companies in the Union, are excluded from the due diligence duty.

4 For some arguments on the full inclusion of SMEs see: West F, (2019) SMEs and the Corporate Responsibility to Respect Human Rights, Busting the Myth that Bigger is Always Better, Shift [online] Available at: https://www.shiftproject.org/resources/viewpoints/busting-myth-smes-corporate-responsibility-respect-human-rights/

5. Broaden the scope of accompanying measures

Art. 14 requires EU Member States to support companies and the partners with whom they have **established business relationships** in their value chain. Such support can range from the operation of dedicated websites, portals or platforms to financial support to SMEs, and the facilitation of joint stakeholder initiatives. The text also requires the Commission to complement Member States' accompanying measures to support due diligence in the Union **and in third countries to help companies fulfill their obligations.**

Nevertheless, it is key to **support upstream suppliers** - beyond those with whom companies have an established business relationship - to enable them to improve their performance and empower them as agents in the HREDD process. This can be done through various means, including capacity building, technical guidance, experience-sharing, and other actions, all of which should be clearly fleshed out in the proposal.

6. Cooperation with third countries should be mandatory

With CSDD we want to raise the floor by improving the livelihoods of those at the beginning of European supply chains, and not only raise the bar by requiring EU companies to deliver on sustainable goals. To make this possible, it is important that the EU and the private sector work together with NGOs and local governments to truly address the root causes of sustainability issues. This is highlighted in recital 49:

> The Commission and Member States should continue to work in partnership with third countries to support upstream economic operators build the capacity to effectively prevent and mitigate adverse human rights and environmental impacts of their operations and business relationships, paying specific attention to the challenges faced by smallholders. **They should use their neighborhood, development and international cooperation instruments to support third country governments and upstream economic operators in third countries addressing adverse human rights and environmental impacts of their operations and upstream business relationships. This could include working with partner country governments, the local private sector and stakeholders on addressing the root causes of adverse human rights and environmental impacts.**

The above commitments should be moved to the core text of the proposal so they become mandatory for the EC and Member States, and further detailed into concrete action plans worked out in cooperation with production countries and relevant stakeholders. The European Commission should not wait to start working on these commitments as this will help build capacity in production countries outside of the EU to comply with the Directive.

7. Embed a gender lens in the due diligence process

Women and girls experience the adverse impacts of business activities differently and often disproportionately. They face additional barriers in seeking access to effective remedies due to gender discrimination, social stigmas, lack of knowledge of their rights, as well as economic and educational disadvantages. Risk identification processes that do not take into account gender inequalities lead to mitigating measures that are ineffective for women. Risk mitigation measures can be so ill-considered that they can actually increase or reinforce gender inequalities.

One reason why gender issues are commonly neglected is due to the fact that legislative and regulatory frameworks rarely include provisions for gender action. This is also true for the proposed Directive. So, if the EU is serious about SDG 5, the proposal should mandate that companies apply a gender lens in each step of the due diligence process. There is an increasing wealth of guidance on gender and due diligence, such as the Gender Dimensions of the Guiding Principles on Business and Human Rights,[5] which could be referred to in the text of the Directive.

5 In addition the "Integrating a gender perspective into supply chain due diligence" document by OECD and FAO provides a good reference for the Agricultural Supply Chains.

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8. Foster collaboration with suppliers instead of focusing on contractual assurances

In the current CSDD proposal, the burden of due diligence is or can be passed off to suppliers through contractual assurances. When looking at the measures companies can take to address adverse impacts, the CSDD proposal relies almost exclusively on mandating contractual assurances from direct suppliers to comply with the code of conduct and action plans. These assurances would come with cascading requirements so other upstream suppliers also commit to comply with these instruments.

What is key here is that this approach leaves open the possibility that companies will push the responsibility up the value chain. [6] Experiences in the textiles and minerals sectors have shown that companies will pass costs and responsibilities up in the supply chain whenever possible, and burden suppliers with costly, repetitive and time-consuming audits. This measure can be good at delivering sustainable supply chains on paper, but by itself it has limited potential to change practices. It risks rendering due diligence a mere ticking-the-box exercise.

The proposal should be strengthened to **prioritize engagement, investments, capacity building, and other supportive measures** beyond first tier suppliers that can also be cascaded upstream. Furthermore, the preventive measure already included in the proposal to provide targeted and proportionate support (Art. 7.2.d) should not be limited to SMEs with which the company has an established business relationship.

9. Prevent a 'cut and run' approach to risk management and focus on long-term supplier relationships

The experience from the EU Conflict Minerals regulation and the United States Dodd-Frank Act shows that there is a risk that companies 'cut and run' from suppliers with sustainability issues, rather than working with them on continuous improvements. The proposal establishes that, when potential impacts could not be prevented or adequately mitigated, companies shall refrain from entering into new or extending the existing relations with the relevant partner. In parallel, companies should take prevention and mitigation efforts (Art. 7.5.a) to address potential impacts only if "there is a **reasonable expectation** that these efforts will succeed in the **short-term**", or terminate the relationship if the potential impact is severe. But that is exactly the point: many of the sustainability issues, like child labour or deforestation, are only likely to be significantly reduced through long-term collaboration. A cut and run approach is thus unlikely to solve key issues in supply chains.

The CSDD does not need to reinvent the wheel here. They can turn to the OECD Guidance which requires companies to consider disengagement from the supplier or other business relationship as **a last resort measure.** No less important: it also requires companies to consider and address the potential adverse impacts of a decision to disengage and actively consult with potentially affected stakeholders. CSDD's clauses should therefore be changed to align with these international standards on responsible engagement.

10. Include a duty to engage

The proposal calls for engagement only "where relevant". Meaningful **stakeholder engagement is always relevant**, as due diligence is a process concerned with impacts on the people and the planet. In some agricultural sectors, **the lack of access to living incomes for farmers is amongst the main issues highlighted by producer representatives**, and yet, it is often overlooked by companies that tend to focus on the human rights that are easiest for them to address.[7] Thus, we recommend that the proposal mandates that the interests and concerns of stakeholders are taken into consideration by companies **throughout the entire due diligence process**, not only when a company deems it as relevant.

Moreover, the Directive should look at ways to **encourage and reward companies for investing and supporting initiatives that allow their suppliers to continuously improve, and raise the floor on humanitarian and environmental goals over time.** The EU's new rules could be a great success if they include a specific 'duty to engage' requirement. It's actually not that difficult – Solidaridad has been helping companies to engage producers for decades.

Conclusion

The EU CSDD directive could make a real difference and could lead the way towards sustainable supply chains globally. But there can not be a fair and sustainable transition without improving the livelihoods of millions of workers, miners and smallholder farmers at the beginning of our supply chains. If our suggestions are taken on board, we believe that the CSDD directive can be more than a new compliance requirement for large companies: it can be the first step on the road towards a fairer and more sustainable future for people, nature, and businesses alike.

6 This paper observes that current market dynamics exacerbate existing challenges for upstream actors trying to do business responsibly Factors include: The reliance on industry schemes by the supply chain is resulting in audit or inspection costs. Difficulties for upstream actors to pass due diligence costs down the supply chain

7 V. Nelson, O. Martin-Ortega and M. Flint (2020) Making Human Rights Due Diligence work for Smallholders in Supply Chains. Available at: https://fairtrade-advocacy. org/wp-content/uploads/2020/06/UoG-HRDD-Full-Report-60pp-FINAL-SECURED.pdf

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