



Fairtrade's initial reaction to the due diligence directive

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Fairtrade finds the European Commission's proposal for a "Directive on Corporate Sustainability Due Diligence" a decent start for the ensuing negotiations.

From the perspective of smallholder farmers and workers in global supply chains, with whom Fairtrade works, three key strengths of the proposal relate to (1) collaboration among companies, (2) purchasing practices, and (3) living wages.

- 1. Strength: The proposal recognizes that to address adverse impacts, companies need to invest, collaborate with other companies, and support small and medium-sized enterprises (SMEs) in their supply chains.**

The proposal recognizes that stricter contract clauses on suppliers are not sufficient to address adverse impacts. This is particularly true in supply chains, where economic power and value are unevenly distributed and very little resources accumulate at the beginning of the chain. In such chains, companies need to cover a major part of due diligence costs and support upstream actors' human rights and environmental work.

Fairtrade is hence very glad to note that the proposal calls for companies to:

- make necessary investments, such as into management or production processes and infrastructures
- provide targeted and proportionate support for SMEs it has established a business relationship with, where compliance with the code of conduct or the prevention action plan would jeopardise the viability of the SME
- collaborate with other entities (Articles 7-8)

Meaningfully, to support due diligence implementation by SMEs, the proposal also

- calls for Member States to offer financial support and information to companies and their partners, and especially to SMEs, at home and "upstream in third countries" (Article 14, Recital 47)
- commits the Commission to support due diligence implementation in and outside of the EU through existing EU tools and projects, and partnership with third countries. These partnerships are to pay specific attention to the challenges faced by smallholders (Article 14)

- 2. Strength: The proposal recognizes that poor purchasing practices cause human rights and environmental violations.**

The Recitals note that "When identifying adverse impacts, companies should also identify and assess the impact of a business relationship's business model and strategies, including trading, procurement and pricing practices" (Recital 34).

This is significant. In global supply chains, common poor practices include insufficient lead times, last minute changes to orders, prices that undercut the costs of sustainable production and fraudulent quality complaints. They contribute to human rights violations, such as excessive overtime and lack of living wages and living incomes.

In the upcoming negotiations, the call for companies to assess and, where relevant, also *reform* their trading, procurement and pricing practices should be included in the Directive itself.

- 3. Strength: The proposal recognises Living Wage as a human right – and sees that companies should also address other adverse impacts that impair the fulfillment of human rights.**

HREDD is to cover a wide spectrum of environmental issues and all internationally recognized human rights. Appropriately, the proposal recognizes that human rights include a living wage and a decent standard of living (Annex, Part I, points 7 and 17).

Further, Recital 25 notes that “a violation of a prohibition or right not specifically listed in the Annex, which directly impairs a legal interest protected in those conventions, should also form part of the adverse human rights impact covered by this Directive”. **Lack of living income for smallholder farmers** is such a factor, as it directly impairs the right of these farmers and their families to a decent standard of living, health, and education.

Four key weaknesses of the proposal relate to (1) termination of contracts, (2) short business relationships, (3) stakeholder dialogue, and (4) coverage of very large companies only.

1. Weakness: The proposal does not deter “cut and run” (sudden termination of contracts)

The Recitals note that to effectively address adverse impacts “companies should prioritize engagement with business relationships in the value chain, instead of terminating the business relationship”. The termination of relationship is labelled as “a last resort action”, only to be taken if other attempts fail (Recitals 36 and 41).

Further, it’s noted that the interests of adversely impacted people always need to be taken into consideration. For instance, “Terminating a business relationship in which child labour was found could expose the child to even more severe adverse human rights impacts.” (Recital 32)

However, the Directive makes no note of any of these points. Rather, it suggests that a company can suspend a commercial relation where it has a “reasonable expectation” that a potential impact cannot be adequately minimized **in the short-term** (Articles 7-8). Further, whenever a potential or actual impact is severe, a company “shall terminate commercial relations” (Articles 7: 5b and 8: 6b).

2. Weakness: The proposed Directive would encourage short-term business relationships, where sustainability is neglected.

The proposal expects companies to conduct HREDD on their own operations, their subsidiaries, and “entities with whom the company has an established business relationship”. The latter is defined as a direct or indirect relationship that is (expected to be) lasting and does not represent a negligible or merely ancillary part of the value chain” (Articles 1 and 3f).

This means that companies could avoid due diligence by switching suppliers frequently.

3. Weakness: The proposal stops short of requiring meaningful dialogue between companies and potentially affected stakeholders.

Meaningful dialogue with potentially affected people is crucial for companies to identify which adverse impacts are most serious and which corrective measures are most meaningful. In many cases, some stakeholders are already taking measures to address the adverse impact and dialogue is needed to achieve effective collaboration.

The proposal nods in this direction and calls for

- corporate directors to consider relevant input from stakeholders when putting in place and overseeing due diligence actions (Article 26)
- consultation with affected stakeholders, where relevant, to identify adverse impacts and develop prevention and corrective action plans (Articles 6-8).

In the upcoming negotiations, it’s crucial to lose the diminutive “where relevant” – dialogue is always relevant, at every single step of the due diligence process, as also recognized by the OECD Due Diligence Guidance. Further, the Directive needs to call for meaningful dialogue and engagement, not mere consultation. Like workers, smallholder farmers also need to be explicitly referenced as stakeholders.

4. Weakness: The proposal only expects HREDD from very large companies.

The proposal only covers companies with over 500 workers and a turnover of €150 million as well as textile, agriculture and minerals extractors, manufacturers and wholesalers with over 250 workers and a €40 turnover. This leaves 99 percent of EU companies out of the scope. In the textile sector, Eurostat data shows that 99.8 percent of companies in the EU have less than 250 employees.

These thresholds need to be lowered significantly, for the Directive to have the sought impact on human rights and environmental sustainability. Further, the retailers of textile, agricultural and mineral products need to be included among high-risk actors, as these retailers' procurement and pricing practices have far-reaching influence on human rights and environmental conduct in these supply chains.

Additional observations:

Negatives:

1. The proposal does not give guidance on the **level of sanctions**, but just calls on member states to lay out "effective, proportionate and dissuasive pecuniary sanctions". (Article 20)
2. The proposal leaves it for national legislators to decide who has the "**burden of proof**" in cases where victims seek justice. This is a large hurdle for access to justice and needs to be corrected. Victims must not need to prove that corporate due diligence has been inadequate; Companies should be expected to prove that their conduct has been adequate. (Article 22)

Positives:

3. Proposed changes to corporate **directors' duties** are modest but valuable. Directors are to
 - a. oversee due diligence actions, considering relevant inputs from stakeholders;
 - b. take short-, medium- and long-term human rights, climate and environmental consequences into account in their decisions;
 - c. and adapt the corporate strategy to take adverse human rights and environmental impacts into account.

In very large companies, directors are also to ensure that business model and strategy are compatible with limiting global warming to 1,5 °C. (Articles 25-26)

4. The proposal gives a balanced view of the role of **industry schemes and multi-stakeholder initiatives** in HREDD: "Companies may rely on industry schemes and multi-stakeholder initiatives to support the implementation of their obligations ... to the extent that such schemes and initiatives are appropriate to support the fulfilment of those obligations. ... The Commission and the Member States ... may issue guidance for assessing the fitness of industry schemes and multi-stakeholder initiatives." (Article 14: 4)
5. The Directive calls for authorities to ensure that **competition policy** does not prevent shared human rights and environmental work by companies: "Member States shall ensure that, for the purposes of due diligence, companies are entitled to share resources and information within their respective groups of companies and with other legal entities in compliance with applicable competition law." (Article 4: 2)

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