Position of ESFAM AISBL on the proposal for a Directiveon Corporate Sustainibility Due Diligence (CSSD Directive)

A. An aim and a scope of obligations that are unfortunately unrealistic

- **Directive and national transpositions** :

The CSSD Directive Proposal's aim is to prevent the emergence of current or future obstacles to the freedom of establishment resulting from the **divergent development of national laws on the matter** (*cf. Directive Proposal, P°10*). Yet, it is important to note that Directives need to be transposed into national law to become effective while Regulations are directly applicable within the Member States' jurisdictions. **As Directives need to be transposed**, Member States are free to choose how to operate such transposition as long as the main principles are respected. Therefore, the very nature of Directives entail a significant amount of discretion of the Member States and therefore related **risks of having different interpretations**. The CSDD Directive Proposal cites the relevant examples of duplication of requirements, difficulties in complying, lack of legal certainty for companies, additional costs and complexity and even mutually incompatible parallel legal requirements (*cf. Directive Proposal, P°11 and P°14*). If we take the example of the Directive 2021/555 and the implementing Directive 2019/68 as regards to firearms' marking, the industry and businesses involved in this sector had to and is still facing a wide range of different interpretations within the EU Member States.

The fact that the CSDD is dealt with by a Directive and not a Regulation in addition to the fact that its wording remains quite vague also raises some concerns as regards to the principle of legality of criminal offences and penalties (*cf. Article 49 of the EU Charter of Fundamental Rights*) according to which offences and penalties must be both accessible and foreseeable in order to prevent any arbitrariness by the courts.

The issue is that as the Directive is not precise enough, Member States will have to take concrete measures to implement it, and there is a significant risk of fragmentation of the internal market. Companies will face an excessive burden so as to be compliant in all the EU Member States. It can also have dramatic impacts leading companies to relocate in the EU Member States which took the less stringent measures especially as regards to the sanctions' regime. Yet, if Member States do not take these concrete measures to implement it, there will be then a lack of foreseeability as regards to the sanctions' regime provided for by the Directive and it is a real obstacle to the principle of legality of criminal offences and penalties.

- **Downstream Due Diligence** :

It is really not clear how can companies be expected to know and monitor what their customers will do with the Products, especially when it goes as far as the disposal of the Products. There is **no realistic way to operate** such downstream due diligence.

Moreover, this raises **particular concern as regards to the Defense Industry sector**. In this specific sector, Downstream Due Diligence is already operated by the national competent authorities when taking the decision to grant or not any export license. In taking such decision, national competent authorities are not free – they have to comply with the Council Common Position 2008/944 and one of the criteria is the respect for human rights in the country of final destination (*cf. Criterion Two*). **The CSDD Directive would thus give the competence to companies while EU Member States are currently granting such competence to their dedicated authorities** – which should be considered as enough and more objective as well as stringent.

- **<u>Upstream Due Diligence</u>** :

The CSSD Directive Proposal indicates itself that the obligations should be "**obligations of means**" (*cf. Preamble (15)*) – yet the same proposal provides for a strict sanctions regime. As expressed by the stakeholders in the diverse public consultations organized by the EU, **we cannot reasonably expect companies to control a whole value chain - their reach can already be difficult towards their direct 1st-tier suppliers in certain circumstances (*e.g. the ones in quasi-monopolistic positions*), going beyond would thus be unrealistic and would impose a disproportionate burden upon companies.**

B. <u>An aim and a scope of obligations that are unfortunately disproportionate</u>

- <u>Other EU Directives/Regulations</u> :

The CSDD Directive Proposal indicates in its explanations as regards to consistency with existing policy provisions in the policy area (*cf. P°3 to P°10*) that such proposal is either completing or reinforcing a wide list of EU Directives and Regulations.

Yet one must note that these Directives and Regulations were not taken on the same **legal basis** than the present Directive proposal which raises thus **concerns as regards to the reasons for and objectives of said Directive Proposal** (*e.g. while the legal basis of the CSDD Directive Proposal is based on Articles 50 and 114 of the TFEU, the legal basis of the proposal for a Regulation on deforestation-free supply chains is based on Articles 191 and 192 of the TFEU and the legal basis of the Conflict Minerals Regulation is based on Article 207 of the TFEU*).

Moreover, some listed Directives and/or Regulations are still under discussion and have not been adopted yet (*e.g. proposal for a Corporate Sustainability Reporting Directive revising the NFRD, proposal for a Regulation on deforestation-free supply chains*) – **one may thus wonder how can the EU Commission have the necessary hindsight to know if such Directives will need to be completed or reinforced.**

Furthermore, the impact assessment is not making it clear on the **reasons why the CSDD Directive Proposal shall go beyond the well-thought and well-defined scope of the listed Directives and Regulations** (*e.g. Conflict Minerals Regulation: they clearly identified four minerals that raised concerns ("The EU regulation covers tin, tantalum, tungsten and gold because these are the four minerals that are most often linked to armed-conflicts and related human rights abuses, so it makes sense to focus on them" -https://policy.trade.ec.europa.eu/development-and-sustainability/conflict-minerals-regulation/regulation-explained_en)– but the present Directive Proposal wants to complete such Regulation by including all the other minerals under a due diligence obligation*). In some cases, there are no explanations on how or why the Directive Proposal is completing/reinforcing such Directives/Regulations (*e.g. Directive 2011/36, Employers' Sanctions Directive, Sustainable Products Initiative*).

Finally, it is important that the EU adopts **a logical and complementary approach** – if the CSRD Directive enters into force before the CSDD Directive, the reporting obligations will be required before the internal processes, which does not make sense and which would *in fine* make the transition period under the CSSD Directive meaningless.

- Trade Secrets :

The Directive 2016/943 on the protection of trade secrets explicitly indicates that confidentiality of **information on customers and suppliers** is a business competitiveness tool (*cf. Preamble (2)*). This Directive has also been taken on the basis of Article 114 of the TFEU. Therefore, how can companies be expected to communicate such crucial and commercially sensitive information to the public and more particularly, to their competitors even if the goal would be to diminish altogether the due diligence' costs by **industry alliances** (*cf. Impact Assessment Report – Annexes - P° 54 and P°56*) ? And what about a potential conflict with **data protection laws**?

Moreover, the CSSD Directive Proposal encourages companies to **conclude contracts with indirect business partners** (*cf. Preamble (40*). But it implies then to require our 1st-tier supplier to disclose to us who is its supplier – what about the protection of its trade secrets ? And it would inevitably create tensions in the business relationship as the company would thus have to override its direct supplier.

- Disengagement from risky markets :

With a scope encompassing **financial institutions** such as payment institutions and insurance companies, the CSDD Directive Proposal will inevitably push them to disengage from risky markets such as the **Defense Industry** one. This was an actual impact as shown by the diverse public consultations organized by the EU (*cf. Impact Assessment Report – Annexes - P° 16 and 28*). Yet, in view of the latest events (*e.g. situation in Ukraine*) the latter has been recognized as essential to ensure the security and safety of EU Member States' citizens and allies and protect EU's values and interests (*cf. Strategic Compass, March 2022*). The CSSD Directive Proposal should thus provide for either an exemption of the Defense Industry (which would make sense in view also of the downstream due diligence already operated by the national authorities – cf. explanations hereabove), either an exemption of financial institutions that are meant to support the Defense Industry in one way or another.

The Directive Proposal indicates itself that account should be taken of the specificities of the company's value chain **sector** (*cf. Preamble (15)*). Imposing such "one-size-fits-all" legal requirements on all sectors might have significant impacts and in this case, adverse impacts in terms of EU capabilities in security and defence.

- Competition :

As expressed many times throughout the public consultations organized by the EU (*cf. Impact Assessment Report - Annexes - P°13, 16 and 28; Directive Proposal p°18*), there is a real risk of loss of competitiveness as all the companies worldwide will not have to face the same obligations and therefore, the **same costs and obstacles**.

There is an actual risk that companies that do not fall under the CSSD Directive's scope will go towards the cheapest options and might grow bigger than EU companies, which would therefore **cause detrimental impacts on EU economy and competitiveness worldwide**.

As explained hereabove in the context of national transposition of Directives, there is also a risk that EU Member States will have a more or less stringent sanctions' regime which would lead companies to **relocate elsewhere**, damaging thus the current internal market balance.

C. An impact assessment and a scope of obligations that are unfortunately not precise enough

- Deficient analysis :

The impact assessment unfortunately shows :

- a **lack of sufficient data** *(e.g. "costs (…) have not been quantified but should remain minimal" P°34, "combined with the lack of sufficient data" P°52, "similarly to the authors of the Supporting study on due diligence, other researchers and organizations also have difficulties with quantifying, let alone monetizing, the costs and benefits of due diligence measures" P°55*),
- a **non-inclusion of important costs** (*e.g. "indirect costs (…) are only partly quantified" P°34, "do not include the (one-off) costs related to rearrangements of companies' value chains P°53, "did not inquire about one-off (initial costs) e.g. for training staff, the set-up of IT solutions and initial risk assessments" P°53, " In order to avoid double counting, the overlapping compliance costs already accounted for under the CSRD proposal should be deducted from the estimated costs implied by this initiative P°66),*
- **some contradictions** (*e.g. "the survey did not inquire about (…) the set-up of IT solutions and initial risk assessments (…) thus, the costs estimates (…) only capture the cost of setting up (…) due diligence processes P°53*) and,
- an **estimation based on the answers of an unrepresentative minority of companies** (*e.g. focusing on the costs of companies that already have due diligence processes in place – their costs will thus be inevitably lower than the ones which does not have anything in place; "the detailed calculations in the study rely on these responses only, despite the fact that the costs that they currently incur does not represent the "average" company of this size P°51) .*

- Vagueness :

Despite the effort of the EU Commission to include a list of definitions, some terms remain quite vague especially those regarding the **value chain and its limits**. The public consultation organized by the EU was also not precise enough (cf. Impact Assessment Report – Annexes – P°25 "*Multiple respondents indicated that they found the online questionnaire to be biased and difficult to answer")* leading thus to a **weak cost/benefit analysis** with shortcomings (*cf. explanations hereabove*). The Regulatory Scrutiny Board even provided a negative opinion with its first comment being that the **problem description** is vague.

- Scope :

While the CSDD Directive Proposal gives different criteria leading companies to fall or not under the scope of the Directive, it remains not clear that it should be an entity by entity approach and not a Group approach in the case of **parent companies and subsidiaries**. Indeed, if the turnover or employee number criteria is not satisfied by the parent company, the latter shall not be considered as falling under the scope of the Directive and shall therefore not be under any reporting obligation. However, it can, of course, be a voluntary choice of the parent company to decide to be in charge and publish the report on behalf of one of its entity that is falling under the scope of the Directive and such possibility should be provided for/authorised by the present proposal.

Moreover, the CSDD Directive Proposal shall not and cannot expect companies to conduct human rights and environmental due diligence on their whole value chain without any limitation, especially if a subsidiary or a 3rd-tier supplier or an end-user do not have any **significant activity in the EU**. In such circumstances, the territorial connection is not present and such obligations cannot thus be justified (*cf. P°15 of the Directive Proposal*).