PERSPECTIVES

Crosscurrents—European Union Fails to Pass Corporate Sustainability Due Diligence Directive & SEC Bails on Scope 3 Requirements

Our perspectives feature the viewpoints of our subject matter experts on current topics and emerging trends.

INTRODUCTION

With the adoption by 196 parties of the Paris Agreement in December 2015, legally binding international climate change arrived. The Paris Agreement requires increasingly aggressive five-year cycles climate action plans which are submitted on a national basis, all pointed toward limiting global warming to 1.5˚C above pre-industrial levels. The five-year cycles include a “stocktake” or evaluation of the plan success, gaps, and future plans. The UN Climate Change Conference (COP28) served as the conclusion of the first global stocktake, and the results were not positive – the current progress would not meet the global warming limit.

The EU and all member states ratified the Paris Agreement. In compliance with the Paris Agreement, the EU is set to become carbon neutral by 2050. The national plan submitted by the EU pledges to reduce emissions by at least 55% when comparing 2030 levels against 1990 levels. The EU’s submittal was framed by the “Fit for 55” package which the EU touts as the global standard-setter to drive worldwide climate ambition.

BACKGROUND

The European Union (EU) has consistently pushed climate neutrality as part of EU countries’ commitment to making the EU climate-neutral by 2050.

In 2008, EU leaders agreed that by 2020 the EU would cut its greenhouse gas emissions by 20% from the 1990 level. This goal was achieved three years ahead of schedule. In 2014, leaders endorsed the objective of cutting greenhouse gas emissions by at least 40% by 2030. In December 2020, the European Council agreed to step up the EU’s ambition. EU leaders endorsed a binding EU target of a net domestic reduction of at least 55% in greenhouse gas emissions by 2030 compared to 1990 (Fit for 55).[1]

The Green Deal, the EU’s climate-neutrality objectives, sets out a comprehensive roadmap to achieve climate neutrality.

The EU’s policies and objectives have positioned the EU as a leader in global climate neutrality. With 450 million residents, the EU is just a fraction of the 7.5 billion world population, but the EU has structured its climate goals to push the rest of the world toward those same goals. For example, in April 2023 the EU Council adopted new rules that create financial incentives to reduce emissions for companies outside of the EU who want to access the EU market. These rules are known as the carbon border adjustment mechanism.

The Committee of Permanent Representatives (Coreper) is the main preparatory body for the Council of the European Union. While not a decision-making body, Coreper is tasked as a working group of permanent representatives from each member state. The representatives are the voice of their respective governments.[2] Coreper ultimately works out the positions of the EU which is then submitted to the Council for adoption. The Corporate Sustainability Due Diligence Directive (CSDDD) did not really fail to pass the European Union. Instead, the text of the CSDDD could not secure a qualified majority from Coreper which resulted in CSDDD being withheld from the Council.

BEHIND COREPER’S LACK OF SUPPORT

Coreper has not published the positions of the member states. However, France reportedly proposed a significant change in the employee census necessary for the proposed directive to apply, increasing from 500 to 5,000 employees which would exempt almost 80% of the companies currently covered.[3] Germany, Italy, and 10 other countries abstained from the vote, and Sweden voted against the directive.[4] Without that support, the directive could not secure the necessary 14 member states with 65% of the EU’s population despite four years of work on the project.

The liberal support for the directive is likely to be diluted in upcoming elections and signals a degradation of the EU’s significant sustainability leadership. The lead negotiator took a hard line stating she is “outraged at the political games being played.” Germany has led the conservative opposition and references Germany’s own sustainability

[1] 5 facts about the EU’s goal of climate neutrality (europa.eu)
[2] https://www.coe.int/en/web/cm/ministers-deputies
[3] https://www.responsible-investor.com/csddd-faces-race-against-time-after-eu-member-states-fail-to-back-text/
[4] https://finance.yahoo.com/news/eu-fails-pass-supply-chain-093000348.html

requirements and the displeasure among the impacted companies as the basis for not supporting the directive.

WHO WOULD BE AFFECTED?

Below is a simplified breakdown of which companies the CSDDD would have impacted as proposed in February 2024:[5]

- **Large EU limited liability companies**
  - **Group 1: +/- 9,400 companies.** 500+ employees and net EUR 150+ million turnover worldwide.
  - **Group 2: +/- 3,400 companies in high-impact sectors.** 250+ employees and net EUR 40+ million turnover worldwide, and operating in defined high impact sectors, e.g. textiles, agriculture, extraction of minerals. For this group, the rules start to apply two years later than for group 1.
- **Non–EU companies**
  - **+/- 2,600 companies in Group 1 and +/- 1,400 in Group 2**
  - Third country companies active in the EU with turnover threshold aligned with Group 1 and 2, generated in the EU.

WHAT WAS TO BE REQUIRED OF AFFECTED COMPANIES?

Below are items which would have been required of companies affected by CSDDD:[6]

- Developing a plan to ensure that their business strategy is compatible with limiting global warming to 1.5 °C, in line with the Paris Agreement (Group 1 companies).
- Integrating due diligence into policies.
- Identifying actual or potential adverse human rights and environmental impacts.
- Preventing or mitigating potential impacts.
- Bringing to an end or minimizing actual impacts.
- Establishing and maintaining a complaints procedure.
- Monitoring the effectiveness of the due diligence policy and measures.
- Publicly communicating on due diligence.

FOCUS ON COMPANY DIRECTORS

The directive proposal also introduced directors' duties to set up and oversee the implementation of due diligence and to integrate it into the corporate strategy. The directive would have required directors to consider human rights, climate change, and environmental consequences of their decisions. Under the directive, compensation for corporate directors would have been impacted should the directors have failed to address climate change through corporate management.

PROPOSED AUTHORITY & ENFORCEMENT

The directive proposal created mechanisms for review and enforcement of the proposed directive. The member states would have appointed internal authorities to supervise the directives including the ability to impose fines for noncompliance. The directive also provided for private rights of action for damages caused by lack of compliance with the proposed directive.

WHAT COMES NEXT?

Supply chains present a significant challenge to regulation. In addition to the difficulties associated with obtaining the necessary information to make an evaluation, double counting and other issues are commonly raised as objections to proposals such as CSDDD. The current political climate in Europe and a move toward more conservative appointees to Coreper lend credence to the belief that CSDDD will be difficult to revive anytime soon.

The latest word from the US Security and Exchange Commission (SEC) is that "the Commission will consider whether to adopt rules to require registrants to provide certain climate-related information in their registration statements and annual reports."[7]

[5] https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1145
[6] Id.
[7] https://www.sec.gov/os/sunshine-act-notices/sunshine-act-notice-open-030624

Reportedly, Scope 3 has been dropped from the SEC's proposed rules.[8] That report turned out to be accurate and was described as "watered-down" from the originally proposed rule.[9] With the vote on March 6, has further clarification of the United States' positioning around supply chain climate reporting adopting a less stringent approach both than what was originally proposed by the SEC and what was long anticipated in the EU. After California jumped into the lead on the issue, many thought the EU was the next to follow. With the EU failing to follow through on its proposed directive, the US faces less pressure to fall into line.

CONCLUSION

UPDATE: The Securities and Exchange Commission (SEC) adopted its final rule [1] on Wednesday, March 5, 2024, that requires companies who file registration statements and annual reports to disclose material climate-related risks. The new rules, which become effective 60 days after publication, are phased in for registrants depending on their filing status, with smaller companies having later compliance dates. As has been well reported, Scope 3 emissions, those greenhouse gas emissions calculated based on activities in a corporate value chain, have been removed from the final rule. For more information, see our follow-up discussion here.

ACKNOWLEDGMENTS

We would like to thank our colleague John Peiserich for providing insight and expertise that greatly assisted this research.

John F. Peiserich is an Executive Vice President and Practice Lead in J.S. Held's Environmental Health & Safety Practice. With over 30 years of experience, John provides consulting and expert services for heavy industry and law firms throughout the country with a focus on Oil & Gas, Energy, and Public Utilities. He has extensive experience evaluating risk associated with potential and ongoing compliance obligations, developing strategies around those obligations, and working to implement a client-focused compliance strategy. Mr. Peiserich has appointments as an Independent Monitor through EPA's Suspension and Debarment Program. John routinely supports clients in a forward-facing role for rulemaking and legislative issues involving energy, environmental, Oil & Gas, and related issues.

John can be reached at john.peiserich@jsheld.com or +1 504 360 8373.

[8] https://www.reuters.com/sustainability/us-regulator-drops-some-emissions-disclosure-requirements-draft-climate-rules-2024-02-22/
[9] https://www.reuters.com/sustainability/boards-policy-regulation/us-sec-vote-long-awaited-overhaul-corporate-climate-disclosure-rules-2024-03-06/
[10] https://www.sec.gov/news/press-release/2024-31
[11] https://thehill.com/business/4513407-nine-states-file-legal-challenge-to-sec-climate-disclosure-rule/