Carbon Matters Winter 2023/24

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In September 2023 the Government announced revised plans for meeting the UK's targets under the Climate Change Act for achieving Net Zero.

These revisions are:

- postpone the ban on the sale of new petrol and diesel cars to 2035. This will bring the UK into line with EU legislation in that respect;
- delay until 2035 the ban on installing new oil and LPG boilers (for households not supplied by the gas grid) and new coal heating. Previously those bans would have been phased in from 2026;
- provide an exemption from that ban for households not supplied by the gas grid, and also for certain other households where low-carbon alternatives would require expensive retrofits, or the installation of a very large electricity connection;
- abolish obligations on landlords to upgrade the energy of efficiency of the properties they let; and
- increase the Boiler Upgrade Grant by 50% to GBP7,500 to assist households to replace gas boilers with low-carbon alternatives such as heat pumps.

The Government also formally renounced certain policy initiatives alleged to be in the pipeline, but which would have required people to share cars, eat less meat or dairy products, cut down on their flying, or have seven bins for recycling.

In announcing these measures, the Government emphasised that it fully intended to comply with the established Net Zero Targets and was confident that the UK would be able to do so.

Rather, the Government presented the proposals as representing a more pragmatic proportionate and realistic approach to meeting Net Zero, which was made possible by the UK's current over-delivery in reducing carbon emissions.

Critics of the Government suggested that the moves were driven primarily by electoral considerations, particularly in terms of capitalising on the unpopularity in Outer London as demonstrated by the Uxbridge by-election. It was also argued that the measures were driven by the particular need to rally disillusioned Conservative supporters, especially those living in rural areas typically not benefitting from a supply by the gas grid. It was also argued that a number of the alleged policies which the Government had renounced had never been realistically planned as Government policy but were simply "men of straw" which had been set up by way of padding or filler for the September announcement.

It remains to be seen whether the Government, or perhaps its potential successor, will continue to deliver on the UK's Net Zero Targets and it is very much to be hoped that this will indeed continue to be the case.

However, it is possible to have some sympathy for an approach which seems intended to make Net Zero more "user-friendly".

The heavy lifting as regards Net Zero will certainly be achieved primarily by energy policy, and the actions of the electricity generating sector in particular. However, much will depend on individuals and households in society at large adapting their lifestyles to help meet the targets.

In a recent article, the Economist magazine suggested that there was more that corporates, particularly utility companies, could do to help individual households make changes which would be very burdensome for those households left on their own. For example, it suggested that rather than require each individual household to install its own heat pump it might be more cost-effective, (and would more rapidly achieve the relevant targets) if utility companies were to establish local heat pumps and then connect them to individual households.

On a wider scale, it seems likely that individual households and consumers would be perfectly willing to adopt a more sustainable lifestyle, in particular by buying and using more sustainable products, if they were made available at an affordable price. It will therefore be for the markets to supply appropriate and competitively priced products.

One example which springs to mind would be the case of electrical vehicles as discussed in this issue of Carbon matters.

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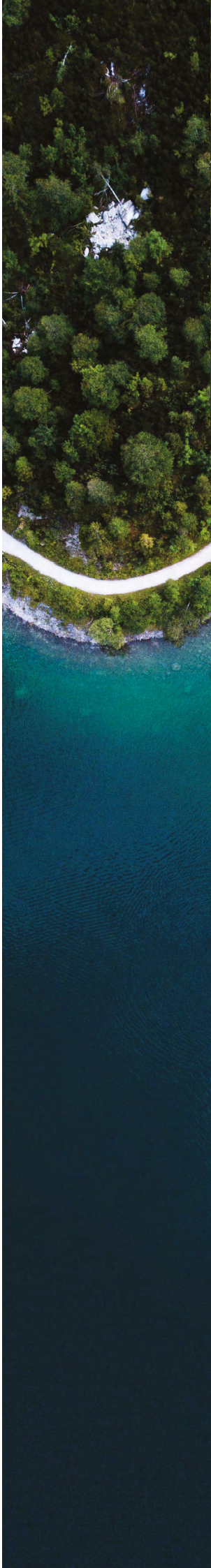

What is the Carbon Border Adjustment Mechanism (CBAM)?

The aim of this new EU law is to prevent "carbon leakage" – and so prevent companies operating in carbon intensive industries from moving their operations outside the EU where there are less stringent climate laws.

It seeks to put a fair price on the carbon emitted during the production of carbon intensive goods that re-enter the EU, and to encourage cleaner production in non-EU countries.

It will be introduced gradually – the immediate concern is the reporting of imports in the fourth quarter of 2023 – with the first report on quantity and emissions from those goods needing to be made in January 2024 for that period. However, the implementing regulations which will set out the methodology to calculate the emissions is still in draft, and there is an ongoing public consultation on this which closes on 11 July.

Further requirements will apply from 2026 – including the need to apply to be an authorised CBAM declarant and buy and sell CBAM certificates.

What products and goods are in scope of CBAM?

- Goods (listed in annex 1) **which originate from third countries**, where those goods *or the processed products from those goods resulting from the inward processing procedure,* are **imported into the EU**.
- The inward processing procedure is from another piece of legislation – it is designed to enable businesses to process goods imported from outside the EU before deciding whether to sell the finished products in the EU or not. After processing, a business can decide to re-export or sell in the EU. An authorisation from the customs authorities is required for the use of the inward processing procedure. This effectively means the import of goods from non-EU countries and the import of goods for processing in the EU into finished products when a decision is made to sell those goods in the EU, are caught.
- The goods listed in Annex 1 are: **Cement**; **Electricity**; **Fertilisers**; **Iron and steel**, and some downstream products of iron and steel (such as screws and bolts); **Aluminium** and some downstream products of aluminium (such as aluminium wire and structures); **Hydrogen** (under the heading of chemicals) – the Commission will assess in the future whether to extend the scope to other goods at risk of carbon leakage, including organic chemicals and polymers, and other input materials (precursors) for these goods.
- The aim is to cover all goods covered by EU ETS by 2030.
- The regulation does not apply to goods originating in the third countries and territories listed in Annex 3: Iceland, Liechtenstein, Norway, Switzerland, Büsingen, Heligoland, Livigno, Ceuta and Melilla. Apart from Switzerland, these are EEA countries, and certain enclaves belonging to EU Members States, but subject to special customs arrangements.

What emissions does this apply to?

- CBAM applies to **emissions of GHGs emitted during the production process of the goods covered**. The GHG covered for the specific products are listed in Annex 1. Carbon dioxide is the main GHG covered, and nitrous oxide and perfluorocarbons from some processes are also included.
- There regulation contains a method on how to calculate the embedded emissions – for some goods (those listed in Annex II which includes some iron and steel goods and all the aluminium goods) only direct emissions need to be taken into account, which are "*emissions from the production processes of goods, including emissions from the production of heating and cooling that is consumed during the production processes, irrespective of the location of the production of the heating or cooling*."
- For other goods, indirect emissions should also be taken into account – "emissions from the production of electricity, which is consumed during the production processes of goods, irrespective of the location of the production of the consumed electricity."

What are the requirements?

Note many of these do not apply until 1 January 2026, however some (application for authorisation as a CBAM declarant) apply from December 2024:

- Goods can only be imported into the EU by an authorised CBAM declarant – applies from January 2026.
- Importers established in the EU shall (before importing goods) make an application for the status of authorised CBAM declarant – if they have appointed an indirect customs representative, this person could submit the application for authorisation – applies for December 2024.
- For importers established outside the EU an indirect customs representative will need to submit the application – applies December 2024.
- Authorised CBAM declarants will need to use the CBAM registry to submit a CBAM declaration for the preceding year – **this does not apply until 31 May 2027, for the year 2026** – this declaration will need to include information such as the total quantity of each type of good imported during the year, the embedded emissions in the goods, and CBAM certificates surrendered.
- Surrendering CBAM certificates is carried out through the CBAM registry. **The first surrender of certificates must be done by 31 May 2027, relating to the calendar year 2026**.
- The amount of CBAM certificates to be surrendered should be adjusted to reflect any carbon price paid for the embedded emissions in a third country and any free EU ETS allowanced that have been allocated to the EU importer.
- There will also be a market to buy and sell CBAM certificates.
- As noted above, there are specific requirements to calculate the embedded emissions and for some goods, only direct emissions need to be taken into account – the authorised CBAM declarant will need to ensure that the total embedded emissions which are declared in the CBAM declaration are verified by an accredited verifier.

What is of immediate relevance to businesses?

- **Reporting obligations will apply to importers from October 2023 until December 2025**. From the calendar year 2026, importers into the EU will be subject to the obligations to submit a CBAM declaration and surrender CBAM certificates as explained above.
- During this period each importer or the indirect customs representative (if non-EU/or an indirect customs representative has been appointed to do this on behalf of manufacturer), having imported goods during a given quarter of a calendar year shall, for that quarter, submit a report ('CBAM report') containing information on the goods imported during that quarter no later than one month after the end of that quarter.
- **The first report will need to be submitted by 31 January 2024 for goods imported during the fourth quarter of 2023**.
- This report will need to include the total quantity of goods, direct and indirect emissions embedded in them, and any carbon price effectively paid abroad for those emissions, including carbon prices paid for emissions embedded in relevant precursor materials.
- There is **currently a consultation ongoing in relation to the methodology to be used to calculate the emissions during this transitional period** – the consultation opened on 13 June 2023 and closes on 11 July 2023.

- The Commission notes that the draft Implementing Regulation on reporting requirements and methodology provides for some flexibility when it comes to the values used to calculate embedded emissions on imports during the transitional phase. During the first year of implementation, companies will have the choice of reporting in three ways: (a) full reporting according to the new methodology (EU method); (b) reporting based on equivalent third country national systems; and (c) reporting based on reference values. As of 1 January 2025, only the EU method will be accepted.

This is what the draft Regulation currently provides on practicalities:

- The report will need to be **submitted by the reporting declarant** – this is either:
  - the importer who lodges the customs declaration for release for free circulation of goods in its own name and on its own behalf;
  - the importer, holding an authorisation to lodge a customs declaration who declares the importation of goods; or
  - the indirect customs representative, where the customs declaration is lodged by the indirect customs representative when the importer is established outside the Union or where the indirect customs representative has agreed to the reporting obligations.
- The report will need to be submitted via the CBAM Transitional Registry – this system will be set up in due course.
- It will need to follow a particular structure as set out in the Annex to the draft implementing regulation – this lists various information which the CBAM report will need to contain.

Next steps

Businesses will need to consider if their activities are in scope (taking into account the goods imported into the EU) and then also need to consider next steps to comply with reporting obligations – however it is worth flagging that until the draft implementing regulation is finalised, this may be subject to change.

Given that there is a staggered implementation period for the different aspects of this new regulation, it is also worth mapping the requirements and a timeline of when steps should be taken to put in place processes and procedures to ensure compliance.

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Green Claims Directive

New Green Claims Directive – Sustainability Disclosure Requirements (SDR) – Companies must keep their hands "green".

The Proposed Green Claims Directive (**Proposed Directive**) was published on 22 March 2023.

Aim of the Proposed Directive

The Proposed Directive is being introduced to combat the increasing number of unsubstantiated "green claims" made by companies that purport their products are better for the environment. The Proposed Directive aims to prevent consumers from being misled by such claims and it is also in line with the European Commission's (**Commission**) overall aim to empower consumers for the green transition, as in Part 1 of the Circular Economy Action Plan.

Other aims of the Proposed Directive include:

- *Empowering consumers* – due to their considerable role in accelerating the green transition.
- *Overcoming consumer barriers* – allowing consumers to make environmentally sustainable consumption choices at the point of sale.
- *Consistency with existing policy provisions* – including Unfair Commercial Practices Directive, Carbon Removals Certification Regulation, Ecodesign Directive, Ecodesign for Sustainable Products Regulation.

What is Greenwashing?

Greenwashing is the deception by businesses to present themselves and their products as more sustainable and environmentally friendly using a range of methods such as claims of product origin, formation, or impact.

"Green Claims" are claims made by businesses to a consumer that state or imply they have:

- Positive environmental impact;
- Lesser negative impact to the environment; and
- No impact on the environment.

"Claims" can include any:

- Text;
- Picture;
- Graphic; and
- Symbol – including labels, brand names, company names or product names, in the context of a commercial communication.

Who will the Proposed Directive affect?

Any EU-based company and any company that makes green claims directed at EU-based consumers.

The Proposed Directive

The accompanying Q&A to the Proposed Directive cites a Commission study from 2020 which found that 53.3% of the "green" claims examined were vague, misleading, or unfounded, and 40% were completely unsubstantiated.

The Proposed Directive sets out that green claims must be:

- Substantiated;
- Have a "life cycle" approach – considering the whole life cycle of a product not just one stage;
- Transparent; and
- Improvement over time for their products, services, or organisation.

Importantly, the Proposed Directive excludes most financial services including but not limited to:

- Banking;
- Insurance;
- Investment firms (funds and advice); and
- Portfolio Management.

(see Recital 10 of the Proposed Directive)

This is because the Proposed Directive is not aimed at changing existing regulation, financial services and their green claims are regulated by the EU Taxonomy Regulation, the Financial Services and Markets Act 2000 and the Financial Conduct Authority.

Substantiated

Any green claim would need to meet a minimum set of requirements as should be set out in delegated acts, which are then independently verified by an accredited verifier. The claim, if proven to these requirements would then receive a certificate of conformity to demonstrate compliance with the Directive. The proposal itself does not set out how to perform such accreditation but does give the Commission the power to adopt any delegated acts.

If another more specific rule applies, then this will take precedence over the Proposed Directive, for example Regulation (EC) No 66/2010 on the EU Ecolabel.

Life Cycle Approach

Any green claims made by companies will need to consider the whole life cycle of the product and not merely focus on one aspect of the cycle which may be "green".

A life cycle is defined in the Proposed Directive as:

"the consecutive and interlinked stages of a product's life, consisting of raw material acquisition or generation from natural resources, pre-processing, manufacturing, storage, distribution, installation, use, maintenance, repair, upgrading, refurbishment as well as re-use, and end-of-life".

For example, a trader could not claim that their product is "green" at one stage of the life cycle if at another their product leads to the creation or increase of other negative environmental impacts.

A further Commission Recommendation (EU) 2021/2279 sets out what methods to use to measure and demonstrate the life cycle environmental performance of products and organisations.

Transparent

Although transparency is not specifically defined in the Proposed Directive, it does set out that a key part of transparency is full communication to consumers. Communication should:

- Cover substantiated environmental impacts;
- Provide information on how consumers can use the product to decrease environmental impacts; and
- Include information on the substantiation e.g., the underlying studies.

Improvement over time for their products, services, or organisation

If a comparative claim against another product or a comparison against the same product at a different point in time is made, then the information and data compared against must be equivalent to the original information and data.

If a claim is made on the basis of future environmental performance of a product or trader, then it must include a time frame for the improvement.

Conclusion

The enhanced scrutiny on companies making green claims means that companies must keep a close eye on their marketing to ensure they do not fall foul of existing or new legislation and regulation. Action has already been taken by interested parties against companies who make such claims, under existing legislation, and the incoming adoption of the Proposed Directive highlights the need for companies' vigilance in an increasingly litigious landscape.

Although it will take time for the Proposed Directive to be approved and possibly amended, once adopted, Member States will have to implement it into their national laws. Whilst, of course, this will not apply to the United Kingdom, all companies who market to EU-based consumers will be required to comply.

Next steps

- Closely follow the adoption of the Proposed Directive to ensure that, once adopted, any environmental claims are substantiated, reliable and verified in accordance with the Directive requirements.
- Ensure all labels used are based on approved certification schemes or established by public bodies.
- Consider and prepare for the increased costs of complying with the Proposed Directive.
- Consider and prepare for new internal processes to ensure compliance.

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Lithium and Electric Cars

In June this year the actor and comedian Rowan Atkinson (perhaps best known for his representations of Mr Bean and Commissaire Maigret) caused something of a stir by writing in an article in the Guardian that he felt duped by the electric car. That was despite the fact that he could be described as an early adopter. He bought his first hybrid vehicle 18 years ago and his first purely electric vehicle nine years ago. He said that he enjoyed both greatly. However, he felt duped because in his view electric cars are not the environmental panacea they are claimed to be.

Mr Atkinson has a relevant background for taking this position. He is well known to be an enthusiast for motor vehicles. Less well known than his acting and comic skills, is that he has a degree in electrical and electronic engineering and a master's degree in control systems.

He said his advice to environmentally conscious friends would be to change to electric if their existing vehicle is an old diesel, and they do a lot of city centre driving. Otherwise, they should hold onto their old vehicle, whether petrol or diesel.

He is less than fully enthusiastic regarding the UK Government's proposal to ban the sale of new petrol and diesel cars by 2030. (Following Mr Sunak's recent announcement that ban has now been deferred to 2035).

While Mr Atkinson accepts that the ban would have beneficial environmental affects in reducing exhaust emissions, he considers that the picture in terms of life cycle analysis is more complex.

He argues that nowadays, motor vehicles have a much greater potential longevity than used to be the case.

While reducing their emissions, we should therefore also be encouraging motorists to keep their existing vehicles for longer. He further argues that there should be a greater focus on certain synthetic fuels and on hydrogen technology.

He is particularly critical of the lithium-ion batteries which are fitted to nearly all electric cars. He considers they are excessively heavy, also requiring large amount of energy to make and have a relatively limited lifespan (from his perspective) of a little upwards of ten years.

My Atkinson's article makes the valuable point that solutions to environmental problems are rarely simple.

However, it seems that, for the time being Industry and Governments are proceeding on the basis that electric cars fitted with lithium batteries will play an important role in moving to net zero, while maintaining consumer lifestyles.

Clearly, if that is to happen electric cars will need to be affordable by a significantly broader section of the public than the likes of Mr Atkinson.

The importance of lithium in providing affordable electric cars has been reflected in recent press reports on policy proposals regarding the classification and labelling of the substance.

An announcement was made at the end of August by the UK Health and Safety Executive that no mandatory classification and labelling as toxic is proposed for lithium carbonate, chloride and hydroxide (the main compounds used for electric vehicle batteries).

In some quarters, this was taken as a sign of a potential regulatory divergence by the UK from the EU following Brexit. That was because last year the European Chemicals Agency (ECHA) issued a recommendation that the three compounds should be treated as "reproductive toxicants".

However, it appears that this recommendation is now being reconsidered, following a recent report which casts doubt on the scientific basis for the recommendation.

If the recommendation were adopted, it would impose significant additional regulator costs on operators of plants which mine and refine these lithium compounds.

It would seem that both in the EU and the UK, the view may be being taken that it would be inappropriate to engage in further regulation of lithium at a time when it is regarded as a key component of electric cars.

Lithium is currently the subject of controversy as regards the automotive industry, in relation to the Rules of Origin contained in the Trade and Cooperation Agreement between the UK and the EU (TCA).

Owing to the complex supply chains in that industry which cross borders between the EU and the UK at a number of points, the competitiveness of the industry in both markets depends on tariff-free trade. That is provided for in the TCA subject to the general condition that 55% of a vehicles value must be made up of components which are locally sourced either in the UK or the EU, depending on where the vehicle is produced. It was recognised during the TCA negotiations that this would pose a particular difficulty in the case of electric vehicles because it is not easy for car makers either in the EU or the UK to source components purely from within their trading area. Hence transitional Phasing-in of the Rules of Origin provisions will apply with the 55% of the vehicles value rule only taking full effect from 1 January 2027.

There are also special rules on batteries which make up a significant part of the value of electric vehicles up to the start of 2024 only 30% of both battery cell and pack need to be of local origin that rises to a requirement of 65% of the cell and 70% of the pack by 1 January 2027.

In due of the difficulties these requirements would pose, even with the benefit of the transitional arrangements, both UK and EU car makers have been lobbying for their amendment. There have recently been significant signs that this lobbying will bear fruit.

In the UK, however, the Rules of Origin have provided an incentive for significant new investments in lithium production. These have notably related to activities in Cornwall, which is one of the poorest counties in the UK.

Imerys British Lithium is a joint venture between British Lithium and the minerals group Imerys. The JV is building on a pilot plant previously built by British Lithium to process lithium extracted from micaceous granite in the St. Austell area. The plant processes the micas to produce lithium carbonate.

Another company in the same county, Cornish Lithium, is carrying out a similar hard-rock lithium extraction project in tandem with a project to extract lithium from geothermal brines contained in Cornish granite.

Both projects promise to bring employment opportunities to a depressed area, as well as contribute to the UK's move to a Net Zero Economy.

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EU 2040 Climate Target

As is by now well known, the EU's climate targets for 2030 and 2050 are contained in Regulation EU 2021/1119 (hereafter "EU Climate Law"). Following the publication of a call for evidence in March 2023, the process of setting the EU's 2040 climate target, which will impact many economic sectors and EU territories, is now underway.

Background: 2030 and 2050 Targets

EU Climate Law sets out the EU's commitment to become the first climate neutral continent by 2050. Known as the *'climate-neutrality objective'*, Article 2(1) of EU Climate Law includes a binding objective of climate neutrality by 2050.

Article 2(1) also makes clear that Union institutions and Member States have to take the necessary measures to enable the collective achievement of this objective. This binding objective was brought into force in pursuit of the temperature goal contained in the legally binding international treaty commonly referred to as the Paris Agreement (a recent European Commission call for evidence reiterated the fact that the world is not on track to meet the temperature goal of limiting the temperature increase to below 2C, let alone 1.5C).

In addition to the 2050 objective under EU Climate Law, Article 4 sets an intermediate climate target for the EU, namely the domestic reduction of net greenhouse gas ("GHG") emissions (i.e., emission after the deduction of removals) by at least 55% compared to 1990 levels by 2030.

The 2040 Target

In addition, EU Climate Law calls on the Commission to make a legislative proposal, based on a detailed impact assessment, to amend the Regulation and include a 2040 climate target.

As part of this process, an initiative containing a call for evidence and consultation was published on 31 March 2023. This initiative gives the public and stakeholders the opportunity to provide feedback until 23 June 2023. The Commission states this feedback will enrich their assessment of a suitable 2040 target, inform the analysis of the sectoral transformation needed to meet this target, and provide input on the possible evolution of climate policy instruments beyond 2030, all of which will be considered as part of the initiative in question.

The initiative states this communication will start the process of establishing a 2040 climate target in order to put the EU on a path to 2050 climate neutrality. The initiative also makes clear an in-depth impact assessment will be produced, as is required under Article 4, which will inform the drafting of the legislative proposal setting out the 2040 target.

According to the call for evidence, the policy options of the impact assessment will focus on different levels of reductions in net GHG emissions by 2040 compared to 1990 (later referred to as '*different ambition levels for 2040*'), taking into account the implications of these options on the GHG budget for 2030-2050 (this is a reference to the indicative total volume of net GHG emissions expected to be emitted without putting at risk the EU's commitments under the Paris Agreement – a report in respect of which must also be published by the Commission).

As per an article authored by the Directorate General for Climate Action, the results of the consultation will be summarised and analysed as part of the detailed impact assessment, and the advice of the European Scientific Advisory Board ("ESAB") will also be taken into account (Article 4(5) confirms the Commission shall consider the latest reports of the Advisory Board, as well numerous other factors).

ESAB's recommendations have recently been released, in June 2023. ESAB recommended maintaining the EU's GHG emissions budget for 2030-2050 within a limit of 11-14 Gt CO2e, in line with limiting global warming to 1.5C. In order to achieve this, ESAB recommend emission reductions of 90-95%, relative to 1990, by 2040. This provides businesses with an early indication of the type of 2040 target certain EU institutions are recommending.

Next steps

The legislative proposal containing the 2040 target has to be introduced at the latest within six months of the Paris Agreement global stocktake (a process designed to assess the global response to the climate crisis every five years, and which is due to take place in late 2023), with a view to then amending EU Climate Law to allow for the inclusion of the 2040 target.

On that basis, it is anticipated that the legislative proposal will be made by mid-2024, given that the outcomes of the stocktake have to be taken into account as part of any proposal (along with the conclusion of various other assessments, as per EU Climate Law).

The impact assessment is also, according to the call for evidence, expected to be published in 2024.

Businesses should therefore remain aware of any developments as we head into 2024 with regard to the 2040 target, as the Commission makes clear in the associated call for evidence that setting such a target will impact many economic sectors and territories in the EU and may require a policy response in areas beyond climate policy.

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Sustainability Update

Corporate Sustainability Reporting Directive

On 31 July 2023, the EU Commission adopted a first set of standards for sustainability reporting for companies. These are the standards against which the first tranche of companies subject to the Corporate Sustainability Reporting Directive (**CSRD**) will have to report for the first time for the 2024 financial year, in reports published in 2025.

That Directive, which entered into force in January 2023 places broader disclosure requirements for companies within the scope of the Directive on matters such as business models and strategy to ensure compatibility with the aims of the Paris Agreement, sustainability targets, and the role of management in meeting them, sustainability risks and how they might be prevented and mitigated.

These sustainability risks include ESG and employment matters, respectively human rights, money laundering and the prevention of bribery and corruption.

The requirements will affect a range of businesses, including some not established in the EU/EEA which do business in the block, as well as a much broader range of large companies and listed SMEs established there.

The new requirements will replace the Non-Financial Reporting Directive for companies as and when they become subject to the CSRD.

Although the new Delegated Regulation on Reporting Standards relates to reporting standards which will apply for the purposes of the CSRD it was made under the Non-Financial Reporting Directive. The Delegated Regulation and the new reporting standards to which it will give effect will now be the subject of scrutiny by the European Parliament and Council.

Taxonomy Regulation

In addition to the new reporting standards, the CSRD will also draw on the EU Taxonomy Regulation which entered into force in July 2020. The Taxonomy Regulation provides a catalogue of sustainable activities primarily for the use of investors and sets out those activities which it is EU policy to encourage but will also provide guidance for reporting under the CSRD. The Taxonomy Regulation was supplemented in June this year by a new set of guidance on economic activities making contributions to non-climate related environmental objectives. These relate in particular to:

- sustainable use of water and marine resources;
- the circular economy;
- pollution prevention and control; and
- biodiversity and conservation.

Corporate Sustainability Due Diligence Directive

In June, the European Parliament adopted as a negotiating text its own version of the Corporate Sustainability Due Diligence Directive, which is known as the CS3D.

A proposal for this Directive was first published in February 2022 by the Commission, and at the end of that year the European Council issued its own negotiating position on that proposal.

The CS3D aims to improve the regulatory framework on human rights and sustainability due diligence. It will harmonise existing due diligence laws already in force in the EU/EEA such as the German law on Corporate Due Diligence Operations in Supply Chains, the French Vigilance Law and Norwegian Transparency Act,

It will also establish consistency between related items of EU legislation including the CSRD, the Non-Financial Reporting Directive (while it continues to remain in force) and the Sustainable Financial Disclosure Regulation.

The CS3D will establish a comprehensive regulatory framework requiring corporate due diligence to identify actual or potential risks to the environment or human rights and the establishment of processes to prevent and/or mitigate those risks. According to the different texts now in existence, the due diligence requirements will apply to "supply chains" or wider concepts of value chain or "chain of activities". These concepts will cover upstream as well as downstream activities and operations across a company's subsidiaries.

The three different texts drawn up respectively by the EU Commission Council and Parliament will now be subject to a "Trialogue" negotiation process between the three Institutions.

That process is intended to conclude by the end of this year.

However, in view of significant differences between the three texts of the proposals the process may well take longer. These differences include:

- the turnover and employee thresholds for companies in scope, and whether or not (as the Council proposed) there should be an initial restriction of scope to very large companies for the first three years of operation of the regime;
- the applicability of the Directive to financial services companies, and whether this should be within the discretion of Member States or cover regulated financial services companies generally;
- the scope of directors' duties, the scope as regards the due diligence, namely whether it should apply to supply chains or a wider concept of value chain and the operators covered;
- liability for civil damages, and whether this should be dependent on proof of fault in the form of intent or negligence;
- the extent of penal sanctions for non-compliance;
- the scope of the human rights and environmental adverse impacts to be addressed by the due diligence requirements; and
- the interaction of the Directive with the existing legislation adopted in a number of Member States.

Accordingly, the message is very much to "Watch This Space". However, businesses which may be affected (including those established outside the EU/EEA) would be wise to set about establishing a due diligence framework, if they do not already have one in place, as well as taking steps to prevent and/or mitigate any potential adverse impact of their activities on the environment and/or human rights.

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