

Traceability and Regulation July 2024

A View by Nicko Debenham of Sustainability Solutions Ltd

Update on Global ESG Regulation that relates to Cocoa

We started reporting on the different ESG-related regulations that are appearing around the world. In May, we gave a specific update on the European Union Deforestation Regulation (EUDR) and updated on the UK Forest Risk Commodities Regulation (FRCR) in June. This article is to tackle a few more of the remaining regulations relevant to the cocoa sector and, not surprisingly, much still comes from the EU.

As a reminder, I have included the table showing the different regulations across the globe.

Region/ Country	Date of Enforcement	Regulation	Commodity	Status	Average Annual Cocoa Imports in Metric Tonnes during 2019/20 to 2021/22				
					Beans	Liquor	Butter	Cake/Powder	Total tonnage
European Union	Jul-20	EU Taxonomy Regulation	All	Current	2,037,021	525,191	621,446	454,068	3,637,726
	2024	Corporate Sustainability Reporting Directive (CSRD)	All	Current					
	Mar-21	Sustainable Finance Disclosure Regulation (SFDR)	All	Current					
	Jun-23	European Union Deforestation Regulation (EUDR)	Cocoa, Coffee, Cattle, Palm Oil, Rubber, Soy, Timber	Current					
	Jun-23	Corporate Sustainability Due Diligence Directive (CSDDD)	All	In Development					
Germany	Jan-23	Supply Chain Due Diligence Regulation	All	Current	434,585	74,138	154,366	67,677	730,767
UK	2024	Forest Risk Commodities Regulation	Cocoa, Cattle (Non- dairy), Palm Oil, Soy,	In Development	90,731	16,398	54,583	19,806	181,518
USA	2017	Tariff Act Section 307	All	Current	391,291	79,709	104,543	170,995	746,538
	2024	Forest Act	Cocoa, Cattle, Palm Oil, Rubber, Soy	In Development					
Australia	Aug-24	ESG Climate Related Financial Disclosure	All	In Development	435	12,100	20,126	16,100	48,761
Japan	Mar-23	Task Force on Climate Related Financial Disclosure (TCFD)	All	Current	36,608	14,346	22,860	21,199	95,013
Switzerland	2020	Environmental Social Governance Regulation	All	Current	7,650	9,991	29,845	5,068	52,555

Source: Nicko Debenham and ICCO Quarterly Bulletin 49 Issue 3

Corporate Sustainability Due Diligence Directive (CSDDD)

The CSDDD is an EU proposal that will require companies to exercise due diligence in their own business and in their supply chains to prevent human rights or environmental risks.

The CSDDD must be transposed by Member States into national law by 26th July 2026. These new rules will become applicable to companies according to a staggered timeline set out below, to enable them to prepare. This means that it will be several years before the new rules take full effect.

Category	Net turnover threshold	Number of employees	Date of application for companies ¹⁴
EU companies	EUR 1,500 m (global)	5,000	26 th July 2027
	EUR 900 m (global)	3,000	26 th July 2028
	EUR 450 m (global)	1,000	26 th July 2029
Non-EU companies	EUR 1,500 m (in EU)	N/A	26 th July 2027
	EUR 900 m (in EU)	N/A	26 th July 2028
	EUR 450 m (in EU)	N/A	26 th July 2029
EU Franchisors/ Licensors	Turnover: EUR 80 m (global)	N/A	26 th July 2029
	Royalties: EUR 22.5 m (global)		
Non-EU Franchisors/ Licensors	Turnover: EUR 80 m (in EU)	N/A	26 th July 2029
	Royalties: EUR 22.5 m (in EU)		

In-scope companies must manage actual and potential adverse impacts of their activities on human rights and environmental matters, arising from:

- (i) their own operations;
- (ii) the operations of their subsidiaries; and
- (iii) the operations of their business partners in its chain of activities

The main due diligence obligations under the CSDDD are "obligations of means", not "obligations of result". Companies are not expected to guarantee that adverse impacts will not occur, nor that they will always be prevented. But they are expected to take "appropriate measures": measures that can achieve the objectives of due diligence.

The principal requirements for a company are:

- to adopt a 'risk-based' approach to human rights and environmental due diligence;
- integrate due diligence into all relevant policies and risk management systems;
- identify and assess actual or potential adverse impacts; and,

where necessary:

- prioritise potential and actual adverse impacts;
- prevent and (where not possible or immediately possible) mitigate potential adverse impacts and bring actual adverse impacts to an end and minimise their extent;
- provide remediation for actual adverse impacts;
- carry out meaningful stakeholder engagement;
- establish and maintain a notification mechanism and complaints procedure;
- monitor the effectiveness of due diligence policy and measures;
- publicly communicate on due diligence; and
- adopting and putting into effect a climate transition plan.

In-scope companies must adopt and implement a transition plan for climate change mitigation which aims to ensure "through best efforts" that the business model and strategy of the company align with the Paris Agreement. Specifically, the transition plan shall contain:

- (i) time-bound targets (including for 2030 and for 2050) and key actions planned for reaching them;
- (ii) a description of decarbonisation levers;
- (iii) an explanation and quantification of investments and funding supporting the implementation of the transition plan; and
- (iv) a description of the role of company management in connection with the plan.

The climate change mitigation includes Scope 1, 2 and 3, and therefore would apply to cocoa farms.

Forced Labour Regulation in the EU

Member state authorities and the European Commission will be able to investigate suspicious goods, supply chains, and manufacturers. If a product is deemed to have been made using forced labour, it will no longer be possible to sell it on the EU market (including online) and shipments will be intercepted at the EU's borders.

Decisions to investigate will be based on factual and verifiable information that can be received from, for example, international organisations, cooperating authorities and whistle-blowers. Several risk factors and criteria will be taken into account, including the prevalence of state-imposed forced labour in certain economic sectors and geographic areas.

Manufacturers of banned goods will have to withdraw their products from the EU single market and donate, recycle or destroy them. Non-compliant companies could be fined. The goods may be allowed back on the EU single market once the company eliminates forced labour from its supply chains.

The regulation was adopted with 555 votes in favour, 6 votes against and 45 abstentions in the European Parliament on 23rd April 2024. The text now has to obtain a final formal approval from the EU Council. It will then be published in the Official Journal. EU countries will have to start applying it in 3 years.

Germany's Supply Chain Due Diligence Regulation

The Supply Chain Act imposes on companies' due diligence obligations which must be complied with, with the aim of preventing or ending human rights or environmental violations. The due diligence obligations along the supply chain extend to the company's own business area and direct suppliers as well as less strict criteria for indirect suppliers.

Tariff Act Section 307 (USA)

This is a USA regulation that prohibits importing any products that were mined, produced or manufactured wholly or in part by forced labour, including forced or indentured child labour. US Customs and Border Protection (CBP) enforces the prohibition.

FOREST Act (USA)

The FOREST Act would prohibit products that have been linked to illegal deforestation from entering the US, building on the Lacey Act, which prohibits illegal timber and wildlife from entering the country. The bill would create the ability for the US to prosecute people and organizations driving illegal deforestation. The bill would also create a fund to help countries transition away from deforestation and create effective enforcement and conservation programs.

SEC Climate Disclosure Rules (USA)

On 6th March 2024, the Securities and Exchange Commission adopted new climate disclosure rules. These rules require companies to publish information that describes the climate-related risks that are reasonably likely to have a material impact on a company's business or consolidated financial statements. The new rules call for a dramatic change in the nature and extent of disclosures US companies are required to make about the impact of climate change. The gathering and reporting of these incremental disclosures may require significant changes to a registrant's systems, processes and controls.

Australia's ESG Climate-Related Disclosure

The draft legislation seeks to introduce mandatory requirements for large businesses and financial institutions to disclose their climate-related risks and opportunities.

Under the new requirements, companies would be mandated to report on material climate-related risks and opportunities, metrics and targets including Scopes 1, 2 and 3 emissions, as well as "any governance or risk management processes, controls and procedures of the entity related to these matters".

The new proposed legislation would apply to all public companies and large proprietary companies required to provide audited annual financial reports to the Australian Securities and Investments Commission (ASIC) that meet specific size thresholds, starting with companies with over 500 employees, revenues over \$500 million or assets over \$1 billion, as well as asset owners with more than \$5 billion in assets, which would begin reporting for fiscal years starting from 1st July 2024. Medium-sized companies (250+ employees, \$200 million+ revenue, \$500 million assets) would be required to begin reporting for years beginning from July 2026, while smaller companies (100+ employees, \$50 million+ revenue, \$25 million+ assets) would begin the following year.

The legislation also includes a phased-in approach for Scope 3 reporting, allowing companies an extra year from the beginning of their disclosure requirements to report on the quantity of their indirect value chain emissions, as well as on the application of liability for reporting, with "limited immunity" for sustainability reports for years until the end of June 2027.

Japan's Taskforce on Climate-Related Financial Disclosure (TCFD)

Under the rules, all listed companies in Japan are required to disclose sustainability related information using the TCFD pillars (Strategy, Metrics, Targets, Governance and Risk Management).

Switzerland's Environmental Social Governance Regulation

The regulation requires that relevant companies under Swiss law are obligated to report matters relating to the environment, particularly CO₂ targets, social and employment matters, respect for human rights and combatting corruption.

There are many climate-related regulations and human rights-related regulations globally. The interesting political mix where Europe is moving right, the UK is moving left, and the USA we await with bated breath, seems not to have slowed the amount of regulation in the pipeline.

August 2024 Instalment

An EUDR Q&A: How am I supposed to manage this?