How Europe can improve the way global extractive companies do business

Setting strong environmental and social due diligence rules

Summary

For decades, the extractive industry – which includes mining as well as oil and gas – has escaped the regulator's eye despite being linked to some of the world's worst environmental and human rights disasters. From the Shell oil spill in Nigeria which caused irreversible ecological damage to Norilsk Nickel's poor wastewater management turning glacial rivers red, it is time this industry is asked to comply with strict human rights and environmental rules.

Now, the EU has an opportunity to regulate this industry via the recently proposed Corporate Sustainability Due Diligence Directive (CSDDD). This new law is a key step forward in the direction of minimising the negative impacts of businesses on the environment as well as people, in global value chains. What the law effectively sets out is rules for companies to have to comply with in order to do business on the EU market.

The European Commission proposed draft however falls short on a few key provisions, namely the text:

- Does not cover all companies in the extractive business, but instead sets a threshold based on revenue and/or number of employees. For the extractive sector, this would mean that around 20% of companies would not be covered by the rules.

- Does not adequately identify environmental risks, nor international environmental law for companies to follow. For instance, water pollution, biodiversity loss or waste management are all key environmental risks that are not defined in the draft law.
- Fails to require all companies to identify climate as an impact category and to require them to report on, with detailed information, their climate transition plans.

In light of this, T&E recommends the EU Parliament and EU governments to strengthen the law by:

- **Expanding the scope of the directive to cover all types of extractive industries, regardless of size.**
- **Including a non-exhaustive list of environmental risk categories, such as air, water, soil, together with relevant environmental laws.** By including specific environmental risk categories, as in the EU Battery Regulation, co-legislators would be providing companies legal certainty as well as a specific set of indicators they must pay attention to.
- **Mandating companies to set plans of climate reduction targets covering the entire value chain (Scope 1, 2 and 3)** as well as disclose interim plans and milestones for 2030 and 2050.

Introduction

In February 2022, the European Commission presented its long-awaited proposal for a directive on Corporate Sustainability Due Diligence (CSDDD). With consumers paying evermore attention to what is going on in the upstream part of the supply chain, from where their food comes from to where their clothes are manufactured, this draft law is a key step forward in the direction of minimising the negative impacts of businesses on the environment as well as people, in global value chains.

With the transition away from fossil fuels and towards cleaner technologies, such as electric vehicles, happening at speed and thereby driving the demand for raw materials like lithium and nickel, it is evermore important that clear rules are set on how we source the minerals and metals needed to decarbonise our economy.

In 2020 the European Commission proposed a draft law on Sustainable Batteries, for the first time setting out clear environmental and social rules companies must respect along their supply chains in relation to key battery raw materials, such as cobalt and lithium. Crucially, the CSDDD aims at going a step further by wanting to apply clear rules on the extractive industry sector in its entirety. This means that the fossil fuel industry, as well as the wider metals and mining sector, will have to comply with human rights and environmental due diligence[1] if they are to do business on the EU market.

At a time where raw materials are very much in the public debate - from how we source them to which countries Europe depends on - the law is a welcome step in regulating an industry that for many decades has escaped the regulator's eye. In this short briefing, T&E presents our analysis of the Commission proposal and our recommendations on how it should be strengthened by co-legislators.

[1] "Due diligence" can be defined as the processes through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse impacts.

Company scope (Art. 2 and 3)

The draft law applies due diligence rules to EU companies that have over 500 employees and a net worldwide turnover of 150 million euros. However, the text also identifies three high-risk sectors: textile, agriculture and extractive industries. The threshold for companies operating in any of these sectors is 250 employees and a worldwide turnover of 40 million euros. For example, a European mining company, such as Eramet, would fall under this threshold as its net turnover for 2021 was of €298m[2].

For non-EU companies, the threshold is similar. However, it is only based on the net turnover linked *not* to the global turnover, but to the one on the EU market. In other words, this would apply to companies selling goods in the EU. For example, Chilean-based chemicals and lithium mining company SQM, which supplies to many EU companies, would most likely fall under this category as their EU sales account for around 20% of their total revenue[3].

If we focus on extractive industries, namely the oil and gas sector but also wider minerals and metals needed for the energy transition, the scope is too narrow. In fact, the scope falls short of the UN and OECD standards which both apply to all companies regardless of size. Similarly, the due diligence rules in the new EU Battery Regulation cover all companies regardless of size.

In the extractive industries business specifically, this narrow scope will not cover exploration projects or even new mining projects such as ones opening up in Europe. Portugal based lithium project Savannah for instance would fall outside of the scope as the company is not yet profitable and does not have more than 250 employees. That means that robust due diligence to ensure responsibly sourced metals will not have to be incorporated into the growing mining projects from the outset, but added later as an after-thought.

T&E has calculated, using BNEF data, that roughly one fifth of companies operating in the extractive industry would be excluded by the law.

Further to this, the draft law requires companies to undertake due diligence only in relation to so-called 'established business relationships.' This is deeply problematic as business relationships that are not lasting would fall outside the scope of the directive. For example, it is not clear if a new supplier would have to comply with these rules as it cannot be defined as an "established" relationship. Another example is linked to raw material shortages. In a world where global supply chains are being disrupted, a company may decide to recur to the "spot market[4]" to secure an additional quantity of a given raw material from an occasional supplier.

[2] https://www.eramet.com/en/investors/financial-figures
[3] https://s25.q4cdn.com/757756353/files/doc_financials/2020/ar/Memoria-Anual-2020_eng_final-(1).pdf
[4] Add definition

The directive should therefore expand the scope to cover all types of extractive industries, regardless of size and should not be applied only to established business relationships.

Environmental protection (Art. 3 and Annex II)

The proposal defines human rights impacts by referring to an Annex which includes a list of violations and also refers to all relevant United Nations (UN) and International Labour Organization (ILO) instruments.

On the environmental side however, a very short list of environmental norm violations is included. As previously analysed by T&E[5], whilst the field of human rights law has a long track-record with a comprehensive body of internationally recognised standards, such as ones from the UN and the ILO, the same cannot be said for the field of international environmental law, which often presents a more fragmented picture. This is therefore unfortunately reflected in the draft law which falls short of ensuring adequate environmental protection, from biodiversity to water.

The approach taken by the Commission in fact risks missing key adverse environmental impacts that can be caused by companies. This is because not all environmental impacts that a company can cause or contribute to are (yet) covered by international conventions. Generally, countries tend to rely on national laws to cover environmental harm. For example, there is no international agreement on the conservation, improvement and rehabilitation of soil. An environmental impact that would not be covered by this law could be the occurrence of a waste spill, such as the Shell oil spill in Nigeria[6], which caused irreversible damage to biodiversity and people's livelihoods.

Further to this, the list of international norms is not complete. For example the Paris Agreement is not included, as well as the Ramsar Convention which is a key, global convention in the protection of wetlands and biodiversity.

Additionally, the proposed approach of an adverse environmental impact would materialise only in case of a violation of a prohibition of an environmental norm (listed in the draft law). For example, a company suffering a chemical spill and polluting a near-by water basin would only be liable if a law protecting water basins is included in the CSDDD. It is clear though that environmental damage can happen even in the absence of a demonstrable violation of an environmental law.

With the current approach a company in the mining industry could ignore their impacts on water consumption, because those impacts do not breach any pre-existing norm listed in the annex. This also goes against the EU precaution and "do no significant harm" principles, i.e. putting in place safeguards to avoid environmental harm in the first place.

[5] https://www.transportenvironment.org/wp-content/uploads/2021/10/DD-Paper.docx.pdf

[6] https://www.amnesty.org/en/latest/news/2018/03/niger-delta-oil-spills-decoders/#:~:text=Swimming%20in%20oil,reality%20may%20be%20even%20worse.

To improve the text and ensure all types of environmental violations are covered, co-legislators should take a similar approach to the one taken by the Council and the European Parliament in the EU Battery Regulation, as outlined in below table. A non-exhaustive list of environmental risks should be included in the CSDDD, together with relevant environmental laws.

Environmental Due Diligence in the EU Battery Regulation

In December 2020, the European Commission proposed the EU Battery Regulation. The proposed law, which covers the entire lifecycle of a battery, for the first time also includes due diligence rules linked to a specific product.

The due diligence rules proposed by the Commission identify environmental and social risk categories companies should pay attention to when conducting their due diligence. The list (covered by Annex X) was presented as follows:

Social and environmental risk categories:

(a)air;	(d)biodiversity;	(g)labour rights, including child labour;
(b)water;	(e)human health;	(h)human rights;
(c)soil;	(f)occupational health and safety;	(i)community life.

Whilst the Commission accompanies the social risks by a (somewhat) comprehensive set of international instruments, the environmental risks were accompanied by only one international convention on biodiversity.

For the reasons presented above on the fragmentation of international environmental instruments, T&E advocated for the list of environmental risk categories to be strengthened to be more specific. In both the Parliament and the Council agreed positions the list was strengthened to look as follows (example from the European Parliament text):

(a)air, ***including air pollution***;

(b)water, ***including access to water, pollution and depletion of freshwater, drinking water, oceans and seas***;

(c)soil, ***including soil contamination from waste disposal and treatment***;

(d) biodiversity, ***including damage to wildlife, flora, natural habitats and ecosystems;***

Climate obligations (Art. 15)

The proposed law sets out an obligation for large companies to ensure they have a strategy (and business model) in place which is compatible with the Paris Agreement thereby limiting global warming to 1.5°C.

The article however fails to define what the exact plan should contain. Without specificity, we risk turning the article into a greenwashing exercise. In line with requirements already present in the Corporate Sustainability Reporting Directive (CSRD), the article should require companies to report on specific targets for 2030 and 2050, as well as emission trajectories and plans compatible with meeting a 1.5°C low or no-overshoot scenario by 2050.

The article should therefore – in alignment with the CSRD – require targets in the short, medium and long-term and report on their progress as parts of their already existing sustainability reports. Furthermore, the law only requires companies to identify the climate impact of their "operations", meaning what is covered by their supply chain therefore only Scope 1 and 2 emissions. When looking at the extractive industries sector specifically, this is hugely problematic as it would automatically exclude Scope 3 emissions leaving out thereby the core business of fossil fuels companies. This would also exclude upstream purchasing, downstream sold products, goods transportation, travel and even financials.

With regards to the scope, as mentioned above, the article currently covers only large companies. This narrow scope automatically excludes a significant portion of companies in high-impact sectors such as the mining industry which accounts for between 4 and 7% of global GHG emissions[7] if we take into account Scope 1 alone.

T&E calls therefore on co-legislators to strengthen Article 15 by mandating companies to set their climate targets in line with the EU's 2050 target for zero emissions, as well as disclose their climate plans with set milestones and targets for 2030, as well as including in the article obligations on Scope 3 reporting.

T&E calls therefore on co-legislators to strengthen Article 15 by mandating companies to set their climate targets in line with the EU's 2050 target for zero emissions, as well as disclose their climate plans with set milestones and targets for 2030, as well as including in the article obligations on Scope 3 reporting.

Conclusion

The CSDDD is a huge step in fostering and promoting sustainable and responsible behaviour throughout businesses' global value chains. With the law already being considered by the European Commission as an important tool in future legislative proposals, such as the upcoming Critical Raw Materials Act, it is imperative that it is strengthened.

---

7 https://www.mckinsey.com/capabilities/sustainability/our-insights/climate-risk-and-decarbonization-what-every-mining-ceo-needs-to-know

If the European Union is to rely on the CSDDD to ensure high environmental and social standards are embedded into global practices of the extractive sector and beyond, co-legislators must ensure that as many companies as possible are covered under the proposal and that environmental and climate due diligence is truly reflected.

Further information

Cecilia Mattea
Clean Vehicles Officer
Transport & Environment
cecilia.mattea@transportenvironment.org
Mobile: +32(0) 456128689