



Department for
Business, Energy
& Industrial Strategy

Lord Callanan
Minister for Business, Energy and
Corporate Responsibility

**Department for Business,
Energy & Industrial Strategy**
1 Victoria Street
London
SW1H 0ET

Darren Jones MP
Chair
Business, Energy, and Industrial Strategy Committee
House of Commons
London
SW1A 0AA

T +44 (0) 20 7215 5000
E enquiries@beis.gov.uk
W www.gov.uk

Our ref:
Your ref:

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Dear Darren,

EU PROPOSED DIRECTIVE ON CORPORATE SUSTAINABILITY DUE DILIGENCE

Thank you again for your letter to me of 25 March 2022 about the European Commission's proposal for a Directive on corporate sustainability due diligence. I acknowledged it in my short reply of 5 April, and I am replying now in the light of the Department's initial consideration of the European Commission's proposal.

The UK's approach to due diligence

I should say at the outset that, whilst the Government keeps under review policy approaches involving corporate due diligence, it currently has no plans to replicate the EU's cross cutting proposal in the UK's framework of corporate governance and reporting. The Government is sensitive to the overall burden of regulation on our businesses. It would need to be persuaded that approaches to mandate due diligence in law are practical, proportionate and would deliver tangible improvements to human rights and the environment.

The Government supports voluntary due diligence approaches by UK businesses to protection of human rights and the environment across their operations and supply relationships as steered by several international frameworks such as the UN Guiding Principles on Business and Human Rights and the OECD Guidelines on Multinational Enterprises. Where these international frameworks are voluntary or standards-based, this means they are not set up for legal compliance by businesses, so the Government does not track their uptake in that way. However, the Government operates a National Contact Point which engages UK businesses to increase awareness and understanding of the voluntary principles and standards for responsible business conduct in the OECD Guidelines. Where business operations and their supply chains are not in line with the OECD Guidelines, the National Contact Point makes voluntary recommendations and follows up with businesses to implement these.

The Government does not intend to replicate the European Commission's proposal for cross cutting mandatory due diligence in the UK's framework of corporate governance and reporting. Directors of UK quoted companies are already held to account on their management of human rights and environmental issues in their annual reporting. They are required to cover material environmental, social and governance issues in their annual reports. These disclosures cover due diligence approaches, where the companies have these. From this year, large public and private businesses are also required to include climate-related financial disclosures in their annual reporting, aligned to the international framework of the Task Force for Climate-related Financial Disclosures.

Looking ahead, the International Sustainability Standards Board is developing international standards to harmonise environmental, social and governance reporting which will help support investment and trade across global markets. Questions of due diligence disclosures may be considered in the context of these standards. The Government is committed to implement Sustainable Disclosure Requirements across the UK economy to green our financial system and drive sustainable investments and, as part of this, has said it will bring forward proposals to allow the UK to adopt the international standards for use by UK businesses.

Large UK companies also already publish annual transparency in supply chain statements according to the world-leading Modern Slavery Act, to show steps they have taken to counter human exploitation across their supply networks. They are encouraged to disclose due diligence approaches in this context, and the Government has committed to strengthen section 54 of the Modern Slavery Act to require organisations to report against key topics including the risk assessment and the due diligence undertaken for their supply chains. The Government is committed to continuing to strengthen its policy approach to countering trafficking and slavery. It will publish a new Modern Slavery Strategy in the coming months.

As the world-leading Environment Act recently became law, the UK is committed to go further than ever before to clamp down on illegal deforestation and protect forests, through a package of measures that will ensure greater resilience, traceability and sustainability are built into the UK's supply chains. Due diligence requirements in this legislation will make it illegal for larger businesses operating in the UK to use key forest risk commodities produced on land illegally occupied or used.

Potential impacts of the EU proposal

There are questions as to how the proposed EU legislation will be made to work given the complex, dynamic international supply networks of the global economy. We would want to be reassured there are not disproportionate burdens, costs and liabilities for the businesses involved. The Government will monitor closely the EU's negotiation of the proposal. We shall communicate our viewpoint as a major trading partner.

Scope

It is not yet clear how many UK companies will fall directly within the scope of the European Commission's proposal. This proposal is in the early stages of the EU's legislative process and its text may evolve as discussions progress in the EU Council and European Parliament. We shall monitor this progress. Under the Commission's proposal, there are two routes by which a UK business might need to report. A UK company generates turnover in the EU, for example, through exporting or via the activities of a branch, which meets the thresholds set out in Article 2 of the proposed Directive. In this case the company would be required to follow the Directive's provisions. Equally, the proposal could impact UK businesses, companies or large sole traders that export to EU companies which themselves are in scope of the proposed Directive. In the case of the latter, it would be likely that UK businesses in

EU supply chains will be asked by regulated EU businesses to meet requirements, provide information or do verification checks. In 2019, there were, according to trade statistics, around 141,000 businesses exported goods or services to the EU¹. Whilst these will not be all in scope under the current proposal – for example if they export final products to EU consumers and are below eligibility thresholds - it is likely that many will provide products to EU businesses, including those in scope of the Directive.

You referred in your letter to the scope thresholds for the proposed Directive and asked me if the European Commission was targeting companies who have capacity to implement due diligence. I should say that, in addition to large companies directly in scope, it is highly likely that small and medium-sized enterprises would be affected where in value chains supplying EU companies in scope of the directive. For example, of the 121,000 businesses that export goods to the EU, 104,000 employ less than 50 employees. The Commission's proposal says that in-scope companies will be required to support SMEs financially, such as by bearing the cost of external checks, and that EU Member States are also encouraged to provide support. However, it seems likely that some UK SMEs may face unsupported costs.

The challenge in estimating scope makes any costings difficult, but the EU Impact Assessment which accompanied the draft Directive, suggests that the annual costs of due diligence could be between 23,000 and 52,000 Euros (approximately £19,000 - £44,000) depending on the degree of due diligence required and the size of the entity.

You also asked about the likelihood of businesses relocating operations in the UK to avoid having to comply with cross-cutting EU rules for corporate due diligence. I cannot speculate about this, not least whilst there remains much uncertainty how EU legislation along the lines proposed would be implemented. We are, of course, committed to sustaining the UK as a great place for businesses to invest and locate and to optimising our business environment so it is internationally competitive whilst upholding our international commitments to high standards.

EU/UK Trade and Cooperation Agreement (TCA)

The TCA recognises the importance of high standards in areas like employment law, environmental protection, and climate policy, however it does not commit the UK to align with EU laws or standards. We retain flexibility to tailor our approach as necessary, whilst reinforcing our role as a global leader in these areas.

Withdrawal Agreement Protocol on Ireland/Northern Ireland

As the Committee has identified, Article 13(4) of the Protocol sets out that where the EU adopts a new act that it considers to fall within scope of the Protocol, but which neither amends nor replaces an EU act already listed in the annexes to the Protocol, the EU is required to inform the UK Government in the Joint Committee. Discussions between the UK and the EU regarding the applicability of the EU's legislation in Northern Ireland would then be held in the Joint Committee, with the legislation only applying pursuant to a Joint Committee decision. To date, the EU has not sought the Government's agreement to add this legislation to the relevant annex of the Northern Ireland Protocol.

¹ For services see:

<https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/datasets/uktradeinservicesbybusinesscharacteristics>; For goods see: <https://www.gov.uk/government/statistical-data-sets/uk-trade-in-goods-by-business-characteristics-2019-data-tables>

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Martin Callanan". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Lord Callanan