THE EUROPEAN COMMISSION'S PROPOSAL FOR A DIRECTIVE ON CORPORATE SUSTAINABILITY DUE DILIGENCE (CS3D): IMPLICATIONS ON UGANDA'S COFFEE SECTOR.

SEATINI
Strengthening Africa in World Trade

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On 23rd February 2022, the European Commission adopted a proposal for a directive on corporate sustainability due diligence for companies to identify and mitigate risks linked to human rights or environmental adverse impacts in their operations and supply chains. The Directive forms part of a larger set of policy initiatives on global value chain sustainability, which were adopted under the umbrella of the European Green Deal. The aim of this Directive is to foster sustainable and responsible corporate behaviour and to anchor human rights and environmental considerations in companies' operations and corporate governance. Furthermore, the Directive requires European Union (EU) companies to ensure that their own operations and those of their supply chains are fully compliant with national and international laws protecting human rights and the environment.

The Directive targets a broad range of sectors considered as high risk, including agriculture and agro-processing, wholesale trade in agricultural goods and manufactured products among others. The CS3D is still work in progress; the European Council and the (EU) Parliament are expected to formally adopt the CS3D proposal early 2024 while the member states have 2 years to domesticate the CS3D in their laws. Whatever eventual proposals are adopted, companies will be expected to identify actual and potential adverse human rights and environmental impacts from their own operations and across their supply chains; take appropriate measures to mitigate or prevent these adverse impacts; and aid stakeholders' rights to access remedies. Companies will also have an obligation to adopt a transition plan to show that their business model and strategy are compatible with limiting global warming to 1.5C in line with the Paris Agreement. This transition plan must identify, on the basis of information reasonably available to the company, the extent to which climate change is a risk for, or an impact of, the company's operations.

As the second African top coffee exporter to the EU, Uganda's exports are subject to the CS3D Directive since they fall under a designated high-risk sector i.e., agriculture and agro-processing. In 2022, Uganda's global coffee exports were recorded at $ 859.94 million.[1] While other export destinations include Sudan, Kenya, Algeria, South Africa, Egypt and Morocco, Europe accounts for 66% of Uganda's coffee exports in April 2022,[2] totalling $573.93 million in 2022.[3] In 2022, leading export destinations of green coffee beans from Uganda included Italy (38.47%), Germany (11.67%), Belgium (5.45%), and Spain (2.54%),[4] with Europe dominating the higher coffee value i.e roasting, grinding and instant coffee processing. With nearly 42% of farming households (1.7 million, 21% of the population) growing coffee,[5] coffee is a critical product for Uganda's trade and livelihoods of many Ugandans. It is therefore critical that the implications of the CS3D Directive on Uganda's

1 UCDA (2022). Report CY 2022/23 Issue 3. Link https://ugandacoffee.go.ug/sites/default/files/2023-01/December%202022.pdf
2 UCDA (2022). Monthly Report May 2022. Link: https://ugandacoffee.go.ug/sites/default/files/2022-06/May%202022_0.pdf
3 Trading Economics, EU Imports of coffee, tea, mate and spices from Uganda. Link https://tradingeconomics.com/european-union/imports/uganda/coffee-tea-mate-spices
4 UCDA (2022). Report CY 2022/23 Issue 3. Link https://ugandacoffee.go.ug/sites/default/files/2023-01/December%202022.pdf
5 Coffee Behind Scenes. Link http://www.coffeebehindthescenes.com/es/country/uganda

coffee sector and value chain are examined so as to ensure that, on the one hand , Uganda's coffee remains competitive on the EU market , while on the other hand , any potential risks are minimised while promoting human rights and environmental sustainability.

Implications of the CS3D Directive on coffee sector in Uganda

On a positive note, the CS3D Directive could have a number of positive impacts on the coffee sector in Uganda. In an effort to comply with the sustainability and ethical standards required by the Directive, this could encourage both large and small-scale coffee producers in Uganda to adopt more sustainable and ethical practices such as using organic fertilizers and implementing fair labour practices. For example, it was estimated that as of 2021, prevalence of child labour in the coffee growing areas of Uganda was at 48%[6] in spite of the efforts taken by the government to eliminate child labour through putting in place a number of policies and institutions. The Directive could also improve supply chain transparency as it requires companies to identify, prevent, and mitigate the risks of human rights abuses and environmental harm in their supply chains, which could improve transparency and accountability throughout the supply chain. Moreover, this could be instrumental given the fact that the government's oversight tends to focus more on the midstream (e.g., aggregation and processing) and downstream (e.g., buyers and exporters) levels, despite findings that work in the downstream supply chain (e.g., coffee planting, harvesting) poses higher risks.

However, we wish to note that the Directive poses a number of challenges to the coffee sector in Uganda. These include:

a) **Likelihood of increased administrative burden and costs for coffee producers and exporters in Uganda**. The Directive requires companies to conduct due diligence to identify, prevent, and mitigate the risks of human rights abuses and environmental harm in their supply chains, which is an expensive process. While over 80% of all coffee in Uganda is grown by smallholders with less than 2 acres per household[7] they often operate as part of bigger company's value chains. Key of the EU/EEA companies who are top buyers of Ugandan coffee include Sucafina (working with over 8,000 farmers)[8],

b) Olam International (with a Germany subsidiary-Deutschland GmbH and working with over 5000 farmers), Ecom Agro Industrialist (working closely with 30,000 farmers[9]), Hamburg Coffee, Bernhard Rothfos, Jacobs Douwe Egberts and Louis Dreyfus among others. Since these companies work with small scale coffee farmers in Uganda, this will require the aforementioned coffee companies to ensure that the small holder farmers who are part of their value chain conduct due diligence which can be cumbersome.

A clear assessment of recitals 47,48 and 49 revels that the EU has removed the application of support measures to SMEs in non-EU countries. This implies that while the burden of compliance falls disproportionately on small coffee producers in countries like Uganda, there are no assured mechanisms and resources to support their compliance. With small-scale coffee farmers in Uganda likely to lack the resources and expertise to comply with these requirements, it could lead to their exclusion from the EU market. . Moreover, coffee SMEs in Uganda lack the ability to invest in required legislative, institutional and infrastructure capacities across the coffee value chain which could ultimately reduce their export competitiveness or cause EU importers to shift to more compliant coffee suppliers. Without offering impactful support to coffee supply chain actors outside the EU, human rights violations and environmental harm may not be tackled effectively, and may result into increased costs of production on small holder coffee farmers. Therefore, recitals 47,48 and 49 of the directive should be reviewed to include binding mechanisms for supporting SMEs (coffee value chain actors) in non-EU countries like Uganda.

c) **Risk of cascading of contractual clauses to small holder coffee farmers in Uganda by big EU coffee companies**. The role of Trading, procurement and pricing practices in facilitating small holder coffee farmers to sustainably produce coffee cannot be overstated. Although the Council has kept the respective wording on ensuring Trading, procurement and pricing practices under recital 30, albeit in a weaker manner, it failed to include it into the draft Due Diligence Obligations for companies. This incoherence may result into EU coffee companies passing their codes of conduct on to their suppliers in Uganda, without addressing potentially harmful practices within their core operations.

6 Global Fund to End Modern Slaver. Link https://gfems.org/wp-content/uploads/2023/01/GFEMS_Child-Labor-in-Coffee-Sector_Uganda.pdf

7 UCDA (2021). Uganda Coffee: Then & Now. Link https://ugandacoffee.go.ug/sites/default/files/2023-03/UCDA%4030%20-%20Coffee%20Then%20%26%20Now.pdf

8 Link: https://sucafina.com/na/origins/uganda?price=USD

9 https://www.ecomsms.com/case_study/kawacom-uganda/

This would result into an effect often referred to as cascading of contractual clauses, as Ugandan coffee exporters may not be in position to implement the CS3D directive if their coffee is fetching low prices.

d) **Risk of power imbalances in the coffee supply chain affecting small actors in Uganda**. As earlier noted, the EU is home to the largest coffee roasting industry in the world, with Germany and Italy having the largest roasting industry followed by Spain, Netherlands, France and Sweden. Leading roasters like Nestlé, JDE Peet's End 2019, Lavazza, and Starbucks are responsible for roasting 35% of the world's coffee, which generated an estimated US$ 55 billion in total revenue in 2019.[10] In 2019, both Nestlé and Starbucks reported sales worth USD 19.5 billion and USD 16 Billion respectively, while JDE Peet's End 2019 a Germany owned roaster launched recently in 2019 was able to sell USD 8.7 Billion in the same year.[11] Furthermore, the Swiss Coffee Trade Association (SCTA) handle a volume of more than 50% of global coffee exports, with members of the SCTA typically buying future coffee contracts from suppliers abroad and resell them to clients who are also abroad, meaning the coffee never touches Swiss soil.[12] There is therefore an already existing violation of the right to fair trade due to the unequal exchanges happening in the coffee supply chain, yet the Directive ignores this fundamental right, which, if well addressed, could tackle other human rights related violations in the coffee sector, e.g., child labour and the fluctuating coffee prices especially at the farmgate.

   The CS3D Directive, while remaining silent on the unequal exchanges between large EU coffee firms and small coffee actors in Uganda could exacerbate these existing power imbalances between coffee producers and buyers. For example, in a bid to remain in coffee business, large coffee buyers and roasters in the EU will require small scale coffee producers in Uganda to apply human rights and environmental protection standards as per the directive. Given the weak language on support measures to SMEs outside EU (Ugandan small holder coffee farmers in this case), this could result in a race to the bottom in terms of prices and quality, but also reduce coffee exports should small holder farmers be unable to comply. Therefore, by not taking into account the Economic Pillar of sustainability e.g., a fair price for producers, the Directive could further marginalize small-scale producers, who already face challenges such as climate change, volatile prices, and limited access to finance and technology.

e) **Risk of displacement of small-scale coffee producers.** Due diligence obligations in the agriculture sector will apply to all companies with more than 250 employees and an annual net turnover of more than 40 million euros (and not only to companies with more than 500 employees). This threshold excludes SMEs, except those which operate in a bigger company's value chain. However, while it is unintended, the CS3D could result in unintended consequences, such as the displacement of small-scale coffee producers and the emergence of large-scale agribusinesses that are better equipped to comply with the Directive. This could lead to further concentration in the coffee industry, reducing competition and innovation and potentially harming the environment and local communities.

f) **Incoherence with trade agreements and Bilateral Investment Treaties (BITs)**. The Directive does not address means of improving coffee value chain in coffee producing countries which is a right to development. Indeed, while it is assumed that compliance with the CS3D Directive will lead to increased income for farmers in sectors like agriculture e.g., coffee, this is not likely given the rigged rules in the coffee supply chain. As earlier noted, trade agreements like the Economic Partnership Agreement (EPA) make it difficult for Uganda to impose taxes on green coffee exports through advocating against imposition of export taxes. This creates a situation where Uganda remains a perpetual supplier of green coffee beans, leading to limited retention of economic value from coffee. Furthermore, Investment Agreements continue to exclude obligations on performance requirements which are critical to promoting transfer of technology, environmental and labour rights protection. Through threatening host states with Investor States Disputes Settlement (ISDS), investors have often reduced the power of the state to regulate investments in interest of communities and the environment. Therefore, separating the CS3D Directive from other critical policies and agreements which are in direct conflict with it leads to incoherence and a likelihood of this policy not supporting Uganda compliance to the Directive.

10 Coffee Barometer 2020. Link https://hivos.org/assets/2021/01/Coffee-Barometer-2020.pdf
11 Ibid.
12 Ibid.

g) **Exclusion of the financial sector**. The role of finance in promoting human rights cannot be overstated. The financial sector is not only undefined as a risk sector but is also excluded from key obligations that apply to all other sectors. The proposal requires financial undertakings to perform due diligence only with regard to the immediate clients of a financial service (instead of the entire value chain) and only where these are not SMEs. This goes clearly against international standards such as the UN Guiding Principles on Business and Human Rights. For SMEs in coffee sector involved in supply chains with big companies, the Directive does not consider the constraints on participation in global value chains by such small actors e.g., limited access to information, credit, and inputs.

h) **Investor State Dispute Settlement may inhibit the implementation of the CS3D**. The CS3D is being proposed in a liberal investment regime which is shaped by ISDS. The existence of ISDS can create a "chill effect" on the ability of governments to regulate in the public interest, including the implementation of the EU directive on corporate sustainability due diligence. As a result, large coffee companies may use the threat of ISDS to discourage governments from enacting or enforcing regulations that could impact their profits or operations, including regulations related to due diligence. Moreover, given their tendency to use precedent-setting approaches, ISDS rulings can set a precedent for future disputes, potentially limiting the ability of governments to regulate in the public interest. This can create a chilling effect on the implementation of the CS3D directive and other environmental, social, and governance regulations.

Recommendations

Ensure a holistic approach to ensure successful implementation: Observance of due diligence requirements in the coffee value chain should be expected from every company, but those requirements should be proportionate to the capabilities and the risk exposure of a company's supply chain. It is therefore essential in particular for coffee value chain SMEs in Uganda that an EU approach provides tailored financial and practical support to create the right incentives for company commitments. This would also contribute to minimizing the risk of disengagement from vulnerable suppliers who, due to their limited negotiation power, would otherwise bear disproportionate obligations and costs, facing severe implications on their competitiveness.

Make cooperation with third parties like Uganda mandatory: The Commission and Member States should continue to work in partnership with Uganda to support upstream economic operators build the capacity to effectively prevent and mitigate adverse human rights and environmental impacts of their operations and business relationships, paying specific attention to the challenges faced by coffee smallholders. They should use their development and international cooperation instruments to support Uganda and upstream coffee value chain operators in Uganda addressing adverse human rights and environmental impacts of their operations and upstream business relationships. This could include working with partner country governments, the local private sector and stakeholders on addressing the root causes of adverse human rights and environmental impact. These commitments should be moved to the core text of the directive so that they become mandatory for the EC and Member States, and further detailed into concrete action plans worked out in cooperation with production countries and relevant stakeholders. The European Commission should not wait to start working on these commitments as this will help build capacity in production countries outside of the EU to comply with the Directive.

Undertake a risk-based due diligence approach: In addition to a holistic approach, a risk-based due diligence approach should be explored so as to: a) encourage companies operating in coffee value chain to work jointly on actions to decrease the level of risk and b) ensure that companies are not dissuaded (e.g. by disproportionate penalties, risk of litigation) from engaging in coffee production where it is actually most crucial to address root causes of human rights and/or environmental impacts. The CS3D directive should therefore ensure effective and robust obligation to prevent and end adverse human rights across the entire value chain in a proportionate manner.

Negotiate support measures: The Uganda government and the EU should negotiate support measures (Accompanying measures) including: Aid and technical assistance for reinforcing national institutional/legislative/infra structure frameworks and monitoring and enforcement mechanisms; financial support to SMEs to help them bear compliance costs while protecting their competitiveness; technical assistance for implementing best practices in human rights and environmental protection; establishing platforms to facilitate exchange of best practices and Lessons Learnt and feedback on challenges highlighted; and agreeing on frameworks in which support could be delivered and monitored.

Agree on performance requirements in free trade agreements (FTAs) and Bilateral Investment Treaties (BITs). While due diligence legislation only mandates in-scope companies to conduct due diligence, all actors in the value chain have actually a responsibility to collect and share ongoing information on risks and impacts, and to communicate on how they are being addressed. All these actors have a role in ensuring that the due diligence process is carried out in inclusive and effective ways that meet the expectations of human rights and environmental due diligence. More especially, Uganda and the EU should ensure policy coherence through agreeing to performance requirements in the FTAs and BITs as these tend to have stringent provisions impeding requirements necessary to promote human rights and environmental protection in coffee value chains e.g., technology transfer, minimum standard of treatment etc.

Link the CS3D to Extra-territorial obligations (ETOs): Known as the Maastricht principles that form a fundamental component of the concept of global justice and international human rights law, ETOs are obligations of states to respect, protect, and fulfil human rights beyond their own national borders.[13] Through ETOs, states have a responsibility to prevent corporations headquartered in their territory from causing or contributing to human rights abuses, even when these abuses occur outside the state's borders[14]. ETOs can help achieve the EU's Directive on corporate sustainability due diligence by ensuring that companies based outside the EU are also held accountable for their environmental and social impact on the EU market. Broadly, ETOs allow human rights to assume their proper role as the legal basis for regulating globalization and ensuring universal protection of all people and groups. By applying ETOs, the EU can extend its legal framework beyond its borders and require companies based outside the EU, but originating from the EU, to comply with the same sustainability standards as those based within the EU.

This can help prevent situations where companies outsource their operations to countries with weaker environmental and social standards, simply to avoid complying with EU regulations.

Address Investor State Dispute Settlement (ISDS). The existence of ISDS can create a challenging environment for the effective implementation of the EU directive on corporate sustainability due diligence. Addressing these challenges may require a more comprehensive approach that considers the interplay between ISDS and the public interest in regulating business practices in a sustainable and responsible manner. This could include reforms to the ISDS system to ensure that it does not undermine the ability of governments to regulate in the public interest.

Link the CS3D with technology transfer: Currently, CS3D discussions are oblivious of the role of technology in supporting compliance in agricultural (coffee) sector in countries like Uganda. Technology transfer can enable coffee value chain actors in countries like Uganda to access new tools and technologies that can enhance their due diligence practices, such as supply chain mapping software, data analytics tools, and sustainability monitoring platforms. This can help companies identify and address sustainability risks and impacts more effectively. Furthermore, can help companies improve their sustainability performance by enabling them to adopt cleaner and more efficient production methods, reduce waste and emissions, and improve resource management. This can help companies comply with the EU Directive on corporate sustainability due diligence by reducing their environmental and social impacts. Therefore, technology transfer should be tied to the implementation of CS3D.

Ensure an inclusive process in the CS3D negotiations: With the EU Council adopting its negotiating position ('general approach') on the corporate sustainability due diligence directive on 1st December 2022, the next steps are for the Council presidency with a mandate to start negotiations with the European Parliament.[15] The EU Parliament should ensure multistakeholder consultations are held both within Europe but most especially in partner countries like Uganda. The due diligence obligation must be strengthened to include

13 FIAN (2017). For Human Rights Beyond Borders: How to hold States accountable for extraterritorial violations. Link https://www.fian.org/fileadmin/media/publications_2017/Reports_and_Guidelines/ETO-Tools_EN-Web.pdf

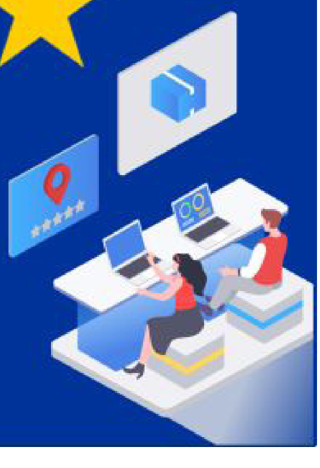
14 Ibid

15 EC (2022). Council adopts position on due diligence rules for large companies. Link https://www.consilium.europa.eu/en/press/press-releases/2022/12/01/council-adopts-position-on-due-diligence-rules-for-large-companies/

meaningful and ongoing engagement, including mandatory and proactive consultation with workers, trade unions, local community members and other relevant or affected stakeholders. This engagement must take into consideration the barriers that specific vulnerable groups face. A multi-stakeholder consultation approach will further ensure that concerns related to right to fair trade, gender and youth among others are effectively addressed.

In conclusion, the coffee sector in Uganda is often associated with various market failures, such as limited access to information about new technologies and state of-the-art and climate-smart farming methods, market requirements or prices, lack of access to inputs required to produce high-value coffee products, lack of access to finance, and high transport and transaction costs to access output markets. This is compounded by the reality that the primary commodity dependence which is defining Uganda-EU coffee trade relationship has led to failure in the transformation of Uganda's coffee sector. While the CS3D directive is important, what is critical for Africa is structural transformation, rather than structural adjustment in order to promote industrialization for decent jobs, value addition, increasing the continent's trade share and developing regional value chains. Furthermore, there is a need to reform the Fair-Trade movement which largely focuses on increasing farm prices for coffee farmers rather than improving on value of coffee exports in order to ensure retention of value in coffee producing countries like Uganda.

EU Directive on Corporate Sustainability Due Diligence



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