

## THE CSDDD EFFECT: ASSESSING THE IMPACT OF THE EU'S IMPENDING CORPORATE SUSTAINABILITY MANDATE ON JAPANESE COMPANIES

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*This issue brief explores the significant impact of the European Union (EU)'s expected Corporate Sustainability Due Diligence Directive (CSDDD) on global corporate responsibility, with a specific focus on its implications for Japanese companies. The CSDDD, which will mandate that companies conduct human rights and environmental due diligence (HREDD) across their value chains, extends the influence of the EU's regulatory policy to companies well beyond the borders of Europe. Japanese companies, which have traditionally been less integrated in HREDD practices, now face a critical need to align their corporate policies with these new standards to maintain their global business relevance. Recent developments, including the release of "Guidelines on Respecting Human Rights in Responsible Supply Chains" by the Government of Japan, have spurred a gradual shift towards more stringent HREDD practices among Japanese businesses. Nonetheless, with the CSDDD set to be finalized by the end of 2024, its adoption will present a number of new challenges and opportunities for Japanese corporate actors.*

### Introduction

In the evolving landscape of international trade, human rights abuses including forced labor, child labor, and human trafficking continue to plague global supply chains. According to the International Labour Organization (ILO), at least 28 million people worldwide were subjected to forced labor in 2021—an increase of more than 3 million people within the past five years alone.<sup>1</sup> Estimates suggest that forced labor and other modern-slavery related human rights abuses

worldwide persist within the private sector,<sup>2</sup> casting a spotlight on the role of both businesses and governments in tackling the problem.<sup>3</sup> Over the past decade, the global rise and recognition of human rights abuses linked to corporate activity has prompted many governments to take action, with some introducing new legislation that have compelled companies to conduct HREDD that assist them in identifying, preventing, mitigating, and accounting for the adverse impacts of their business activities on people and the planet.<sup>4</sup>

In February 2022, the EU formulated a new set of rules that aim to promote corporate respect for human rights and the environment. Through its proposed CSDDD, the EU has put forward a legislative framework that would oblige companies to demonstrate how they are protecting the environment and mitigating the negative impacts of their business activities.<sup>5</sup> If adopted in its current form, the CSDDD would not only introduce requirements for companies to conduct HREDD within their own operations, but also require they do the same for their subsidiaries and other entities located across their value chains.<sup>6</sup> By the end of 2024, the CSDDD is not only set to reshape how large multinationals operate in the EU, but its impact will likely extend far beyond the borders of Europe to reach businesses in Asia.

The CSDDD will be of particular relevance for corporate actors in Japan, as many large Japanese multinationals have yet to fully integrate HREDD throughout their operations, and these same companies will likely be subject to the Directive's compliance requirements due to their substantial investments in 'high risk' areas across Southeast Asia and other developing countries.<sup>7</sup> Thus, to better assess the policy impact of the CSDDD on Japanese and other Asian companies, this issue brief pierces through the complexities of the CSDDD to discuss its far-reaching implications on the Asia-Pacific region.

## **What is the CSDDD, and When Will it Go into Effect?**

The CSDDD is an EU directive designed to foster responsible corporate behavior throughout global value chains. If enacted in its current form, the CSDDD would require companies to monitor their supply and value chains<sup>8</sup> for human and environmental rights risks, and establish processes to mitigate these risks.<sup>9</sup> The CSDDD is a companion law to the EU Corporate Sustainability Reporting Directive (CSRD), which

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bears a similar acronym and intent, but represents a different set of sustainability reporting and disclosure requirements.<sup>10</sup>

Since the European Commission published its initial proposal of the CSDDD in February 2022, the European Council and European Parliament have been working separately on their own versions.<sup>11</sup> After both the Council and Parliament adopted their positions on the CSDDD in December 2022 and June 2023, respectively, negotiations known as the 'trilogue' began to finalize the text and eventually enact the Directive into law.<sup>12</sup> At the time of publication of this issue brief, it is unclear when the text will be finalized and enacted, but there is an expectation that this should occur by late 2024.

One of the major points of discussion during the trilogue negotiations continues to be the exact scope of the CSDDD. Initially, the European Commission proposed that the Directive would apply primarily to companies both within and outside of the EU with more than 500 employees and a net worldwide turnover of €150 million.<sup>13</sup> There remains debate, however, about the exact criteria the EU will use to implicate companies under the Directive, including their size, industry, and annual revenue. Notably, the Council highlighted that the CSDDD would broadly

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apply even to non-EU companies that do not have a branch or subsidiary within the EU.<sup>14</sup> Another point of contention of the trilogue negotiations is whether the EU will adopt a “phased-in approach” in the final version, as recommended by the Council.<sup>15</sup> If this type of approach is adopted, it would mean that in the early stages of the CSDDD’s enactment, the Directive’s new rules would apply only to “very large companies” that have more than 1000 employees and annual turnover of above €300 million per year.<sup>16</sup> Only three years after the Directive’s entry into force would these obligations then be extended to all businesses.<sup>17</sup>

Following the conclusion of the trilogue negotiations and the proposal’s adoption, it will be transposed to the domestic laws of individual EU member-states within the following two years—giving companies only a short window to both understand and comply with the Directive’s requirements.<sup>18</sup>

## **The UNGPs and International Standards**

The CSDDD draws on and complements existing frameworks on responsible business conduct

including the United Nations Guiding Principles on Business & Human Rights (UNGPs) and the Organization for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises. The UNGPs are the most significant, as they helped to revolutionize the field of corporate sustainability following their adoption by the United Nations Human Rights Council in June 2011.<sup>19</sup> Principally, the UNGPs articulated the responsibilities of states to protect and corporations to respect human rights in business activities. They also introduced and popularized the concept of ‘human rights due diligence’, a means by which companies can scrutinize their value and supply chains to identify, prevent, mitigate, and account for the adverse impacts their business activities may cause or be directly linked to.

At the domestic level, several countries have pre-empted the CSDDD and integrated mandatory supply chain due diligence into their own regulatory frameworks.<sup>20</sup> Most recently, both Norway and Germany have enacted legislation that is similar to CSDDD.<sup>21</sup> Although the Norwegian legislation focuses specifically on protecting human rights and the German legislation incorporates environmental protection, both laws are based on the UNGPs and core guidance documents like the OECD Guidelines for Multinational Enterprises.<sup>22</sup> This common foundation—aligned with international standards—makes it substantially easier for companies operating within both jurisdictions to adhere to international law and comply with the CSDDD once it enters into force.

## **The CSDDD Will Likely Apply to Japanese Companies**

As mentioned above, as trilogue negotiations are currently underway, the scope and coverage of the CSDDD is not yet clear. However, these negotiations are considering a June 2023 amendment proposed by the European Parliament that sets the CSDDD’s scope as covering (1) non-

EU companies exceeding EUR 150 million in global turnover, provided that at least EUR 40 million is generated from within the EU, and (2) non-EU parent companies with more than 500 employees exceeding EUR 150 million in global turnover, provided that at least EUR 40 million is generated from within the EU.<sup>23</sup>

Under this proposal, many large Japanese companies will be required to comply with the CSDDD's requirements, as transposed via the local laws of EU member-states where those companies operate. This will especially be the case for Japanese companies with substantial investments in Asia-Pacific countries,<sup>24</sup> where the risk of human rights violations, such as forced labor, are particularly acute.<sup>25</sup>

This means that such Japanese companies will be required to do the following:

- Integrate HREDD into their corporate policies, including a due diligence policy that is updated and published annually;
- Identify actual or potential adverse human rights and environmental impacts arising out of their own operations or those of their subsidiaries, and where related to their value chains, from their established business relationships;
- Prevent and minimize potential adverse impacts and bring actual adverse impacts to an end and mitigate their extent;
- Establish and maintain a complaint procedure;
- Monitor the effectiveness of their due diligence policy and measures; and,
- Publicly communicate on due diligence by publishing an annual statement on their website.

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under the coverage definition of the CSDDD may be compelled to adhere to the Directive’s requirements. Indeed, Japanese companies that *do business with* companies that are covered under the CSDDD will have to respond to requests for information (RFIs) from those latter companies because those companies will be conducting HREDD of their business partners. These RFIs will seek information about their Japanese business partners’ own HREDD practices, and may even make continued business relationships conditional upon those partners putting in place such practices. Thus, the CSDDD’s requirements will “cascade” via the value chain, encompassing Japanese businesses that do not fall under the Directive’s coverage definition.

### **Many Japanese Companies Are Already On the Path to Compliance**

Although the CSDDD is yet to be finalized, Japanese companies have already started to put

in place certain HREDD components that are consistent with the Directive’s expected requirements. This is largely due to Japanese companies’ quick uptake of the “Guidelines on Respecting Human Rights in Responsible Supply Chains” (the “Japan Guidelines”), which were recently released by Japan’s Ministry of Economy, Trade and Industry (METI) in September 2022.<sup>26</sup> The Japan Guidelines followed the government’s 2020 “National Action Plan on Business and Human Rights,”<sup>27</sup> and are based on the UNGPs, the OECD Guidelines for Multinational Enterprises, and the ILO’s Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy.

Generally, the Japan Guidelines state that businesses should respect human rights—i.e., internationally recognized human rights, including freedom from forced labor and child labor, freedom of association, right to collective bargaining, and freedom from discrimination. To that end, they suggest that companies take the following steps:

- Adopt a human rights policy, developed in consultation with experts and stakeholders, approved at the most senior level of business, and publicized both internally to employees, business partners, and other relevant stakeholders, and externally to the general public.
- Conduct human rights due diligence, in which the company identifies adverse human rights risks and impacts in its operations, takes actions to prevent or mitigate those adverse risks and impacts, and evaluates the effectiveness of those actions over time. “Adverse impacts” are those that a company’s activities directly or indirectly cause or contribute to, or to which a company is linked through its business relationships. Thus, the Guidelines contemplate, for example, suspending or terminating the contracts of global suppliers that do not respect human rights.
- Implement grievance mechanisms, which are open to all stakeholders, to receive complaints of and remedy adverse impacts to human rights.

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Critically, Japanese companies’ adoption of these steps has been rapid. Based on a recent survey conducted by the Japan External Trade Organization (JETRO), 64.8 percent of large Japanese companies have already implemented

a human rights policy.<sup>28</sup> About 28.8 percent of these companies are already conducting human rights due diligence. Among the companies that are already conducting due diligence, over 70 percent of them are requiring global suppliers to be compliant with their human rights policy.

### **The CSDDD Will Place Additional Obligations Even on Japanese Companies Adhering to the Japan Guidelines**

Most fundamentally, the Japan Guidelines are non-binding, whereas the CSDDD's requirements will be binding. Indeed, the CSDDD is likely to have some form of civil liability for violators, and while a point of contention in trilogue negotiations, also personal liability for corporate directors. Thus, once the CSDDD requirements come into force, the compliance rates mentioned in the survey above are expected to rise dramatically.

Moreover, even those Japanese companies that are faithfully adhering to the Japan Guidelines will find themselves having to take extra steps to comply with the CSDDD's requirements. As an initial matter, the Japan Guidelines only refer to "human rights due diligence," whereas CSDDD proposals refer to "human rights and environmental due diligence."<sup>29</sup> Thus, Japanese companies will also have to address the adverse environmental impacts of their operations. As another example, the Japan Guidelines refer generally to "supply chains," whereas CSDDD requirements will apply to the broader "value chains," thus expanding the scope of entities over which Japanese companies will have to conduct due diligence.

To be sure, Japanese companies that are impacted by the CSDDD's requirements will no longer be able to simply rely on compliance with local Japanese laws. Indeed, the broader scope of the CSDDD reflects the broader point that, in certain respects, Japanese human rights protections are

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narrower than their EU counterparts. For example, Japanese anti-discrimination and harassment laws, in practice, do not have much focus on religion, disability, or race as protected categories, while the international human rights standards incorporated into CSDDD do. Thus, Japanese companies will likely be compelled to take a much broader view on legal compliance once the CSDDD is finalized and enters into force.

In preparing for the implementation of the CSDDD's broader requirements, Japanese companies should not lose sight of the Japan-specific human rights issues that the Japan Guidelines are intended to address. For example, the Japan Guidelines specifically call out the country's Technical Intern Trainee Visa Program as carrying a high-risk of forced labor. This visa allows Japanese companies to bring into Japan individuals hired outside Japan for manual labor work with low pay, thus creating a foreign workforce that is vulnerable to exploitation.

### **Conclusion**

To conclude, as international standards on corporate responsibility evolve, Japanese companies are at a pivotal juncture. The CSDDD,

a significant step by the EU to mandate human rights and environmental due diligence, heralds a new era of accountability and transparency in global supply and value chains, whose impact will be felt even by companies outside the EU. Indeed, with substantial investments in Southeast Asia and elsewhere in the developing world, Japanese multinationals will be compelled to navigate the complexities of the CSDDD and incorporate new HREDD policies and procedures. Even if Japanese companies are not directly covered under the CSDDD, they will likely be pushed to conduct HREDD by their EU and other business partners that *are* covered under the Directive. While the recent Japan Guidelines have laid a foundational framework for addressing adverse human rights impacts, the CSDDD's wider scope and obligatory nature call for a more rigorous approach—and for more work to be done.

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## Endnotes

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