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European Commission proposes deforestation due diligence rules

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On 17 November 2021, the European Commission ("***Commission***") published a Proposal for a Regulation on placing on the EU market and exporting from the European Union wood, cattle (beef), cocoa, coffee, palm oil and soy and derived products associated with deforestation and forest degradation ("***Proposed Regulation***" or "***Proposal***"). According to the Proposal, those products can no longer be placed or made available on the EU market, nor can they be exported from the EU market, unless they are deforestation-free. The Proposal is presented as part of the European Union's initiatives to address climate change, such as the European Green Deal. The publication of the Commission's legislative proposal comes in the wake of COP26, where global leaders, including the European Union, made pledges to stop deforestation.

This Client Alert sets out the key elements of the Proposal that are of interest to producers, traders, importers and exporters of wood, cattle (beef), cocoa, coffee, palm oil and soy as well as some derived products.

What is the purpose of the deforestation due diligence rules?

The Proposed Regulation seeks to minimise consumption of products coming from supply chains associated with deforestation or forest degradation and increase EU demand for legal and "deforestation-free" commodities and products. By curbing deforestation and forest degradation linked to EU consumption and production, the Proposal is also intended to reduce EU-driven GHG emissions and biodiversity loss.

What products are targeted?

The Proposal currently covers six commodities (**wood**, **cattle** (beef), **cocoa**, **coffee**, **palm oil** and **soy**), as well as derived products such as leather and chocolate ("***covered goods***"), that are listed in Annex I. The Commission does not exclude the possibility of expanding the product scope of the Proposed Regulation.

How are deforestation and forest degradation defined?

The Proposal focuses on the environmental sustainability of products on the EU market.

The Proposal defines "deforestation" as being the conversion of forest for agricultural use, whether human induced or not. Furthermore, "forest degradation" is defined as harvesting operations that are not sustainable and cause a reduction or loss of the biological or economic productivity and complexity of forest ecosystems, resulting in the long-term reduction of the overall supply of benefits from forests, which includes wood, biodiversity and other products or services.

Importantly, operators placing covered goods on the EU market must ensure that: (i) only deforestation-free products are allowed on the EU market; (ii) those products have been produced in accordance with the relevant legislation of the country of production; and (iii) the goods are covered by a deforestation due diligence statement which operators or traders must submit through an information system to be established under the Proposal.

Are deforestation and forest degradation in any country covered?

The Proposed Regulation applies to the covered goods originating in any country. Unlike the CBAM Proposed Regulation, which exempts from its scope third countries that are subject to the EU Emissions Trading System ("***EU ETS***") or that have a domestic emissions trading system linked to the EU ETS, no exceptions apply.

A **benchmarking system** will identify countries as presenting a low-, standard- or high-risk of producing covered goods that are not deforestation-free. The objective of the benchmarking system is to incentivise countries to ensure stronger forest protection and governance, to facilitate trade and to better manage enforcement efforts by helping Member States' competent authorities to focus resources where they are most needed, and to reduce companies' compliance costs. Through the benchmarking system, the Commission will assess the risk that countries or parts thereof are producing covered goods that are not deforestation-free. The obligations for operators and Member States' competent authorities will vary according to the level of risk of the country of production. While many details are still outstanding, the benchmarking system is particularly likely to raise concerns under WTO law.

Must all companies comply?

All companies that produce or sell the covered goods within the European Union or export those goods from the European Union must comply. Additionally, EU and foreign producers of the covered goods will be impacted because their products must meet the Proposal's requirements in order to be exported from or sold in the European Union. For instance, an EU producer of coffee will need to ensure that the supply chain is deforestation-free, and therefore confirmation of that status must be obtained from related traders or distributors.

"Operators" are natural or legal persons who in the course of a commercial activity, place the covered goods on the EU market or export them from the European Union. For imported products, the operator is the first entity or person established in the European Union who buys or takes possession of such commodities. Thus, EU importers may qualify as operators. "Traders" are defined as any natural or legal person in the supply chain other than the operator who makes available on the EU market relevant commodities and products. In principle, SMEs are also covered by the Proposal.

What are the main obligations?

Covered operators must show that the goods: (i) have been produced on land that has not been subject to deforestation or forest degradation after 31 December 2020; (ii) have been produced in accordance with the relevant legislation of the country of production; and (iii) are covered by a due diligence statement which operators or traders must submit through an information system to be established under the Proposal.

As part of the due diligence obligations, operators must:

- ensure the **traceability** of the covered goods: covered operators must collect relevant information on the covered goods regarding the supply chain and geographic coordinates of the plots of land where the covered goods were produced and harvested;
- carry out a **risk assessment**: covered operators must demonstrate that there is no or only a "negligible" risk of non-compliance; and
- take adequate and proportionate **mitigation measures**: where the risk assessment did not show the absence of a (negligible) risk of non-compliance, measures mitigating the identified risk must be taken. Mitigation measures include requiring additional information, data or documents, undertaking independent surveys or audits.

Covered operators must register with a new European information system, accessible by Member States' authorities and customs, and submit a statement confirming that they have successfully completed the due diligence requirements. An anonymised version of the information system will be available to the wider public. Audits and enforcement will take place at Member State level, by designated competent authorities.

How will the mandatory due diligence requirements be enforced?

Enforcement will take place at Member State level. The competent authorities in each Member State will be responsible for imposing penalties, such as fines, the confiscation of the covered goods and possibly also of revenues, the suspension or prohibition of relevant economic activities and the exclusion from public procurement processes for the operators and traders that violate the Proposed Regulation.

The Proposal also envisages a complaints procedure, whereby persons and entities may submit "substantiated concerns" to the competent authorities on how operators and traders are failing to comply with their obligations. The competent authorities will then have to assess the concerns raised and take the necessary steps, including checks and hearings of operators and traders.

What are the next steps?

By 2023, the Commission expects to have obtained the approval of the European Parliament and to have finalised the legislative process.

Compliance with the Proposed Regulation will become mandatory for large companies 12 months after its entry into force, while microenterprises will benefit from a 24-month grace period.

With more than 30 years of experience in trade and customs law and policy, Van Bael and Bellis advises governments, international trade associations and companies in numerous jurisdictions on a broad range of trade related matters.

Our trade team advises on cross-cutting legal issues, including in the context of trade and environment, such as carbon border adjustment mechanisms (CBAMs) and trade in environmental goods and services. We have extensive experience in assisting both governments and the private sector in meeting their compliance objectives. In advising on compliance, our lawyers build on their practical experience gained while engaging with domestic authorities and their insights into how supply chains work.

Van Bael & Bellis also advises governments and multinational companies on trade negotiations, assists governments in assessing compliance of their domestic legislation with relevant WTO agreements and FTAs and helps clients with managing the risk of dispute settlement and developing dispute prevention strategies.

Our lawyers also have extensive expertise in WTO dispute settlement proceedings. Van Bael & Bellis has assisted WTO Members in a large number of disputes involving various sectors and different WTO Agreements, including the General Agreement on Tariffs and Trade 1994 (GATT 1994), the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement), the Technical Barriers to Trade Agreement (TBT Agreement).

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