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ESG Hot Legal Issues for Food Manufacturers

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Environmental, social and governance (ESG) considerations are top of the agenda for all businesses, in all sectors, globally, but the food and drink industry faces a unique set of challenges, from environment planning to supply chain risks and human health.

The impact of these issues is far-reaching and difficult to measure, which, in turn, presents challenges to investors looking to support sustainable businesses on their ESG journeys, and for those running businesses.

Recent conversations with clients inform us that businesses are particularly concerned, and understandably so, about staffing and labour shortages, the energy crisis, sustainability, raw material resourcing and related costs. Add to this a changing legislative framework and reporting requirements, variations in reporting regimes across different jurisdictions, and the concept of ESG can seem very overwhelming. Ultimately, ESG is about doing business in the right way, making business decisions for the wider good.

In the past, the concept of sustainability was seen to have reputational purposes for a brand, but now it presents a significant competitive advantage. In the food and drink industry, businesses need to be transparent in their messaging, because consumers in this sector want to know about the origins of the product, the health benefits and the environmental impact of its manufacture. Ultimately, the transparency that consumers seek will benefit businesses in the sector in achieving their ESG agenda.

In our recent experience, it is evident that ESG is becoming key in the decision-making process with both businesses and investors. The concepts are being used to assess business operations by investment decision-makers. From a due diligence perspective, we are helping clients to look at what they are investing in, what fits with their own ESG agenda and will not create additional risk. As a result, those companies with better ESG credentials are more attractive to investors, they have stronger brands, and they command greater value.

Similar trends are reflected in consumer behaviour. Today, consumers are looking for brands that align with their own values. They are looking at how businesses are paying their executives, how employees are sourced and treated, what sustainable actions a brand takes, and any environmentally conscious practices. Consumers are willing to change their consumption habits based on impact, and investors are willing to follow the course of those decisions, as investors like brands where consumers are willing to pay more.

Looking down the supply chain, the food and drink industry suffered a significant impact on supply chains as a result of the pandemic, forcing businesses to overhaul their previous logistics, find new suppliers and mitigate new risks. The supply chain is a key point of analysis in due diligence, and it is hugely complex. It is, therefore, important that businesses have a strong understanding of their supply chain from a legal perspective in order to mitigate any risks and to recognise the value creation within the supply chain.

The pandemic also forced businesses to re-evaluate their workforce, particularly in the food and drink sector, where there was a demand to keep operations running. Employees themselves are looking at how they are managed, protected and supported in their work environment. Businesses need to recognise that caring for the workforce is essential for sustainability. Where a business can demonstrate that it cares for its employees, it will attract more talent, and through that achieve greater sustainability.

While there is a wealth of ESG-related challenges facing the food and drink sector, we have selected a handful of matters that are most pressing to the sector at present.

Environment

The European Green Deal

The European Green Deal is an umbrella policy that sets the scene for current and incoming EU environmental regulation. It is the place to start when understanding what changes are in the pipeline for businesses operating in the EU.

Announced in December 2019, the European Green Deal sets out a roadmap to becoming the first carbon neutral continent by 2050. It comprises more than 50 actions in relation to efficient use of resources, climate change, renewable energy, the circular economy, biodiversity, pollution, buildings, transport, food systems, agriculture and green finance. Any business operating in the EU should take note of the document to understand what lies in store in the coming years, and what changes are likely to be coming down the track in line with these policies.

However, it is important to note that while the Green Deal was published when the UK was a member of the EU, the UK has subsequently started to map out its own direction, not necessarily always in line with the EU Green Deal roadmap. It is, therefore, recommended that businesses consult both UK and EU sustainability strategies and policies. For more support in this area, please get in touch with Anita Lloyd.

Extended Producer Responsibility (EPR)

Packaging policy is a key component of the EU Green Deal and the EU Circular Economy package. The idea of EPR is that producers of packaged products should be responsible for the full end-of-life costs for any packaging that they place on the market. Another feature is eco-modulation, which is differentiating the cost that producers pay on the basis of the environmental impact of the product. If it is harder to recycle (e.g. complex composite packaging made with various materials), you pay more, but for easily recyclable packaging (e.g. cardboard), you pay less.

Producer responsibility for packaging already exists across the UK and the EU, but there are key features of this "extension" that manufacturers and importers need to be aware of. EPR should be implemented before the end of 2023 in the EU. Following its departure from the EU, the UK will no longer be following the EU timetable, and instead will implement EPR in phases, starting in 2024, with eco-modulation being introduced in 2025. The UK EPR scheme will initially only include household-type packaging, while industrial packaging will continue to fall under the existing packaging regime for the time being.

With these deadlines just around the corner, it is imperative that producers assess the impact and composition of their packaging in order to minimise the additional costs associated with EPR. The shift to a "full end of life costs" model, compared to the current UK system, has been estimated as potentially representing a ten-fold increase in costs for producers.

Managing Labelling for Recycling

By the end of March 2026, all UK packaging except for plastic films and flexibles will have to be labelled as either "recyclable" or "do not recycle", using the WRAP "recycle now" scheme logos. The regime will apply to films and flexible plastics by March 2027. The motivation behind this change is to communicate in a more consistent way to consumers so that we achieve better results from the household recycling system, and better recycling rates overall.

There is a long lead time for this change to be implemented, but it is imperative that manufacturers start planning for the necessary adaptations to their packaging – and of course the scheme can currently be used on a voluntary basis as well.

Food Contact Materials

Many manufacturers will already be aware of proposals at the EU level to amend rules in relation to recycled content of food contact materials. At present, the European Commission is in the process of repealing the legislation and the new regime will come into effect later this year.

The existing regime has not fully been implemented because the European Food Standards Agency (EFSA) has not in practice issued the authorisations envisaged by the regime.

The new regulation sets out a different system, with approved technologies being listed in an Annex.

To date, the only recycling technology approved in the draft regulation is post-consumer mechanical recycling of PET. All other technologies are deemed to be "novel" and will be subject to a new review process. While you do not need authorisation to start using novel technology, you do need to notify the regulator, and there is an extensive information requirement in doing so. Moving forward, EFSA will evaluate new novel technology through this notification system and decide whether the technology should be authorised and incorporated into the existing regulation.

For businesses operating in the EU, it is important to be aware of divergence between UK and EU policies. The UK is not currently proposing the same regulatory changes, so the procedures for authorising/approving recycling technologies for FCM may well be different in the EU and UK. Post-Brexit, it seems that the UK does not have the same capacity and resources to pursue the same level of regulatory change as the EU.

UK Plastic Packaging Tax

The UK Plastic Packaging Tax is a significant new regime that has just been introduced, and it affects many food and drink manufacturers.

This tax came into force on 1 April 2022, and is levied on finished plastic packaging components that are produced or imported into the UK (whether imported as unfilled packaging components, or as packaging around imported goods). It applies to components that contain less than 30% recycled plastic by weight. The idea is to shift packaging producers toward using recycled content, but it is not as simple as it sounds.

There can often be uncertainty when applying the rules in practice as to where in the supply chain the packaging is taxable, what items are in and out of scope, and what constitutes a finished product. It is, therefore, essential that businesses give full consideration to this new regime, and understand if and how they are affected – if you already meet the thresholds for the application of the tax, then the first registration deadline was 30 April. For support in this area, please get in touch with Anita Lloyd

Mitigating Risk

Greenwashing

Businesses understandably work hard to communicate what differentiates them, their values, and why the consumer should choose them. With the increased focus on sustainability, the promotion of environmentally friendly practices by brands is a popular way of burnishing green credentials. As a consequence, there have been recent examples of companies facing accusations of misleading consumers with exaggerated or false claims. This has become known as greenwashing. Companies need to take great care to ensure that any public claims are substantiated because the consequences of misleading claims are likely to include regulatory scrutiny, which comes with an opportunity cost, financial penalties and ruinous reputational damage.

The Workforce

The younger generation, in particular, take ESG matters very seriously, using such criteria to select their employer. People want to work for businesses that have a strong vision and purpose – they want to feel engaged, part of the company culture, and to know that their work is meaningful. Given the demographic of the food and drink industry, the need to attract and retain committed employees at a time of unprecedented labour shortages, becomes ever more important.

The Supply Chain

The supply chain poses a significant risk to businesses where it is not managed effectively, due to the number of components that fall outside of the business's primary control. It is also an increasingly prominent focus of investors and executive decision-makers for ensuring full legal and regulatory compliance.

First, it is necessary that businesses have a sound understanding of their supply chains, have assessed any risks, and made the appropriate adaptations by way of mitigation. Second, where supply chain disruption arises, the way in which a business responds can also have a profound effect on brand reputation and investor attitudes.

Modern Slavery

In the UK, businesses should already be compliant with the Modern Slavery Act (2015), but it is interesting to note that both the EU and the US have recently announced significant legislative changes to forced labour laws.

For businesses importing into the US, there are significant requirements to be aware of, coming into force from 21 June 2022. From this date forward, any product that is produced or manufactured in the Shanghai region of China (this includes any part of the product or packaging) and imported into the US will be assumed to have been made as a result of forced labour unless the company can demonstrate otherwise. This is an interesting development, where we have not previously seen supply chain legislation extend to such lengths, nor put the onus on the importer to disprove an assumption.

While ESG presents a plethora of opportunities for businesses, opportunities and risk also come hand in hand. Essentially, ESG is an amalgamation of a number of risks that existed for a number of years and businesses need to ensure that the risks are integrated in risk management systems across the company. It is advised that businesses integrate the identification, assessment and management of risks into an existing framework to ensure that the risk is not dealt with in silos.

There has been a lot of new legislation in the environmental operational space, of late. Yet, the way of doing business, in particular the risks and the themes that ESG addresses, is not new.

A key area in which we are supporting clients at present is in corporate reporting, where there are many additional responsibilities and complexities being put on businesses.

In April 2022, there was a broadening in scope of the businesses that need to report to the Taskforce for Climate-related Financial Disclosures, now applying to the majority of large private companies (companies with more than 500 employees).

Where businesses are trading globally, the EU has a slightly different approach to achieving carbon neutrality by 2050, which any business who trades globally will need to accommodate.

Moreover, there is also EU taxonomy regulation in the pipeline, which aims to identify and categorise what constitutes a sustainable business.

It is evident that the themes of risks we are seeing are not new – rather, they are evolving. Thus, in order to effectively mitigate risk and capitalise on the associated opportunities, businesses need to stay abreast of these changes.

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