

Proposal for a Directive on Corporate Sustainability Due Diligence: initial analysis

Brussels, 23 February 2022

Overview

Under this proposed Directive, companies will be required to conduct human rights and environmental due diligence along their operations, subsidiaries and value chains.

The due diligence process comprises of the six steps defined by the OECD Due Diligence Guidance for Responsible Business Conduct¹: a) integration into company policies, b) identification of actual or potential adverse impacts, c) prevention and minimisation of impacts, d) establishment of a complaints procedure, e) ongoing monitoring, f) public reporting.

Strengths of the proposal

The proposed Directive introduces mandatory human rights and environmental due diligence for companies, going much beyond the scope of the German supply chain act. It will apply to companies of a smaller size than the German act, will encompass the entire value chain, will more extensively cover environmental impacts and it will allow companies to be held liable for harm. It will also introduce a general duty of care for directors and require companies to adopt a plan to align the corporate strategy to the green transition.

Weaknesses of the proposal

The proposed Directive fully exempts SMEs, even those operating in high risk sectors, and when it comes to non-EU companies its application is very limited. While the proposal covers the entire value chain, due diligence applies only to the new concept of “established business relations”, which may create significant loopholes. Due diligence is further simplified and limited for certain companies based on size as well as other characteristics (such as financial sector companies). The liability provisions could be improved.

Scope of companies included

- Full due diligence:
 - EU companies with more than 500 employees **and** worldwide net turnover of more than EUR 150 million;
 - Third-country companies with a net turnover of at least EUR 150 million in the EU.
- Simplified due diligence:

¹ and aligned with the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises.

- EU companies with more than 250 employees **and** more than EUR 40 million worldwide net turnover **and** whose turnover was generated partly (over 50%) in high-risk sectors;
 - Third-country companies with net turnover of more than EUR 40 million in the EU and whose turnover was generated partly (over 50%) in high-risk sectors.
- For companies under the “simplified due diligence” scope, the requirements are limited: they will only need to conduct due diligence with regards to severe adverse impacts, and they will have a longer transition period, as obligations will apply only three years after the transposition of the directive.
 - High-risk sectors: textiles, agriculture and food, minerals, metals and mining².
 - According to the Commission’s calculations, the Directive will apply to 13 000 companies in the EU, and 4 000 third country companies.

Analysis:

The complete exclusion of SMEs means that 99% of businesses in the EU will be allowed to continue business as usual; such an exclusion is therefore unacceptable. We welcome the high-risk sector focus as a tool to enlarge the scope to smaller companies, but do not find it reasonable that this should mean that only simplified due diligence is needed. On the contrary: companies that operate in high-risk sectors should conduct intensified due diligence in order to identify and address the risks in question.

The long transition period for large companies of over 250 employees and over EUR 40 million worldwide net turnover operating in high-risk sectors does not seem justifiable, especially given that they are required to only carry out simplified due diligence. Companies of such a large size are well able to adapt to the requirements without needing an additional three year phase-in compared to the other companies under the scope of the Directive.

The differentiated approach to EU and non-EU companies endangers the level-playing field, as EU companies of smaller worldwide turnover will be required to fulfil the obligations of the Directive compared to their third-country counterparts.

Due diligence obligation

- The due diligence applies to own operations and subsidiaries, as well as established business relations in the entire value chain.
 - An “established business relation” means a business relationship, whether direct or indirect, which is, or which is expected to be lasting, in view of its intensity or

² “the manufacture of textiles, leather and related products (including footwear), and the wholesale trade of textiles, clothing and footwear; agriculture, forestry, fisheries (including aquaculture), the manufacture of food products, and the wholesale trade of agricultural raw materials, live animals, wood, food, and beverages; the extraction of mineral resources regardless from where they are extracted (including crude petroleum, natural gas, coal, lignite, metals and metal ores, as well as all other, non-metallic minerals and quarry products), the manufacture of basic metal products, other non-metallic mineral products and fabricated metal products (except machinery and equipment), and the wholesale trade of mineral resources, basic and intermediate mineral products (including metals and metal ores, construction materials, fuels, chemicals and other intermediate products.”

duration and which does not represent a negligible or merely ancillary part of the value chain.

- The due diligence applies to human rights and environmental impacts. The Annex defines those:
 - Human rights: the Annex provides a list of 20 specific human rights issues, such as violation of the right to a fair wage, violation of the prohibition of child labour and forced labour, violation of the right to freedom of association, violation of the prohibition to unlawfully evict or take land, forests and waters. The Annex adds also a general protection for issues not covered in that list but protected under the main international human rights conventions.
 - Environment: the Annex provides a list of conventions on biodiversity, chemicals and waste. It also adds certain environmental impacts under the human rights list mentioned above, namely: "Violation of the prohibition of causing any measurable environmental degradation, such as harmful soil change, water or air pollution, harmful emissions or excessive water consumption or other impact on natural resources, that:
 - a. impairs the natural bases for the preservation and production of food or
 - b. denies a person access to safe and clean drinking water or
 - c. makes it difficult for a person to access sanitary facilities or destroys them or
 - d. harms the health, safety, the normal use of property or land or the normal conduct of economic activity of a person or
 - e. affects ecological integrity, such as deforestation"
- Limited due diligence when it comes to financial sector: when a financial sector company is investing, providing a loan or credit it only needs to conduct due diligence at the inception of the contract.
- Industry schemes: companies may rely on industry schemes and multi-stakeholder initiatives to support the implementation of their due diligence obligations, to the extent that such schemes and initiatives are appropriate to support the fulfilment of those obligations.

Analysis:

It is great that the directive covers the entire value chain, instead of only direct suppliers. However, limiting the due diligence to "established business relations" creates a significant loophole whereby companies might avoid having long-lasting relations to individual suppliers in order to avoid the legal responsibility. Additionally, this term does not exist in the UN Guiding Principles on Business and Human Rights and hence would signify a limitation of existing notions of due diligence.

Human rights and environmental impacts are thoroughly covered, though a legal analysis is required to ensure that there are no gaps in protection.

Limited requirements on the financial sector seem unjustified. As with all the other companies covered under the scope of the Directive, financial undertakings should have to carry out ongoing

due diligence, not only before giving the loan or credit or making the investment but also throughout the entire process in which the activity being financed takes place.

It should be clarified that while companies may make use of industry schemes, their participation in such schemes is not enough to comply with the obligations introduced by this Directive and that the ultimate responsibility for the due diligence process lies with the company itself.

Climate change

- Member States shall ensure that companies adopt a plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement.
- This plan shall identify the extent to which climate change is an impact of the company's operations. Should climate change be identified as a key impact of the company's operations, the company must include emission reduction objectives in its plan.
- These considerations shall be taken into when setting directors' remuneration.

Analysis:

It is extremely welcome that all the companies under the scope of the Directive will need to adopt a plan to align the company with the green transition and address the company's impacts on climate change.

Directors duties

- The proposal outlines that directors should be responsible for putting in place and overseeing the due diligence actions of the company.
- In addition, a general duty of care for directors is introduced to take into account the consequences of their decisions on sustainability matters, including human rights, climate and environmental consequences, including in the short, medium and long term.

Analysis:

While the directors' duties introduced by the proposal are not as comprehensive as originally envisaged by the European Commission, it is welcome that a general duty of care is introduced.

Enforcement: administrative sanctions and civil liability

- **Administrative sanctions:** Member States should designate one or more national supervisory authorities, responsible for enforcement and entitled to carry out investigations. Member States should provide for dissuasive, proportionate and effective sanctions for infringements of the due diligence obligations. The administrative sanctions should include pecuniary sanctions. The European Commission will set up a European Network of Supervisory Authorities.
- **Civil liability:** Member States are required to lay down rules in line with the provisions of this Directive, governing the civil liability of the company for failure to comply with its due diligence obligations.

- The civil liability applies for damages arising from own operations, subsidiaries and established business relations (where the company has regular, lasting and frequent cooperation with that business relationship). For the latter, liability applies only where the adverse impact could have been foreseen, prevented, ceased or mitigated with appropriate due diligence measures.
- Liability is excluded when the damage relates to an indirect partner where the company did conduct due diligence, unless it was unreasonable for the company to expect that its due diligence actions would be adequate.
- Member States shall ensure that the liability provided for under this Directive is of overriding mandatory application in cases where the law applicable to claims to that effect is not the law of a Member State, i.e., the EU law will apply even in cases where the harm took place outside the EU.
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Analysis:

It is crucial to combine both administrative as well as civil liability, and it is therefore very welcome that the proposal introduces a civil liability clause to ensure that companies can be held liable for harm and to improve victims' access to justice. It is particularly welcome that the proposal clarifies that EU law will apply to cases where the harm took place in a non-EU country.

Nevertheless, the proposal conditions liability for harm taking place in the value chain only to situations where the company has a regular, lasting and frequent cooperation with the supplier in question. This could have the unintended effect of European companies designing their supply chains in a way that guarantees them more distance and constant change instead of closer cooperation in order to avoid liability.

Furthermore, the proposal limits liability even further in cases of human rights and environmental harm taking place with regards to indirect suppliers. Here, the proposal suggests that a company shall not be held liable unless it can be proved (assumedly by victims) that its due diligence actions had been unreasonable. Here a reversal of the burden of proof would be key, so that the onus is put instead on the company to prove that it did conduct reasonable due diligence.

An additional concern is that leaving it up to the Member State to clarify what is considered reasonable and who should prove this unreasonableness could lead to a situation where the harmonised rules are endangered due to narrower or broader interpretations of this term.

Timeline

- **Transposition** into national law should take place 2 years after entry into force of the Directive. Regarding the obligations for companies in high risk sectors where simplified due diligence applies, the transition period is of 4 years after entry into force of the Directive (2 years after transposition).
- **Review clause:** 7 years after entry into force of the Directive, a review should be carried out with regards to the company threshold, the list of high risk sectors, the annex on human rights and environmental impacts, and whether there is a need to extend due diligence to adverse climate impacts .

Analysis:

The longer transition period for companies in high-risk sectors which will have to carry out simplified due diligence is not justifiable.

The review clause is very welcome. A review should be carried additionally with regards to possible need to further harmonise administrative provisions.

Import ban on forced labour products

The Directive on corporate sustainability due diligence does not include a mechanism to ban the imports of products made with forced labour. On 15 September 2021, the European Commission President Ursula von der Leyen had announced that she will ban products made with forced labour from being sold in the EU single market. This followed from an intensive [campaign by the Greens-EFA Group for such an import ban](#).

Yet since the announcement, the Commission had been busy with internal fights over how to concretise this, and whether to include some kind of forced labour ban within the due diligence proposal. Instead, the Commission has now decided that the forced labour ban will be developed as a separate instrument, as demanded by the European Parliament.

In its Communication on decent work worldwide, published also on 23 February, the Commission clarifies that it is preparing a new legislative proposal that will effectively prohibit the placing on the Union market of products made by forced labour, including forced child labour. The new initiative will cover both domestic and imported products and combine a ban with a robust, risk-based enforcement framework. The European Parliament demands a proper import ban, such as the one that exists in the US and other countries.