DODS | POLITICAL INTELLIGENCE

European Commission's proposal for corporate sustainability due diligence

Political & stakeholder reaction

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Overview

The European Commission has set out plans for new rules to ensure large companies operating in the European Union respect human rights and the environment in their global value chains.

The **Proposal for a Directive on corporate sustainability due diligence,** published on 23 February, would require companies to identify, prevent, or mitigate any adverse actions by their suppliers around the world, for example on the use of child and forced labour, or pollution and biodiversity loss. The Commission said the rules, which will be debated by the European Parliament and EU member states, would bring legal certainty and a level playing field to companies and increased transparency for consumers and investors.

Didier Reynders, the Commissioner for Justice, said the proposal was a game-changer in the way companies operate their business activities throughout their global supply chain. "With these rules, we want to stand up for human rights and lead the green transition," he said. However, the proposal received a mixed response from stakeholders, with some business groups saying it was unrealistic to expect companies to police their global supply chains while environmental groups said the rules did not go far enough. The Commission said the proposal, part of the European Union's "Just and sustainable economy package", would build on the **UN's Guiding Principles on Business and Human Rights** and **OECD Guidelines for Multinational Enterprises and responsible business conduct, and was in line with internationally recognised human rights and labour standards.**

This Dods EU Political Intelligence report provides an outline of the Commission's proposal and some of the initial political and stakeholder reactions to it.

Proposal for a Directive on corporate sustainability due diligence

The Commission's proposal will require the companies within its scope to:

- Integrate due diligence into their policies.
- Identify actual or potential adverse human rights and environmental impacts.
- Prevent or mitigate potential impacts.
- End or minimise actual impacts.
- Establish and maintain a complaints procedure.
- Monitor the effectiveness of the due diligence policy and measures.
- Publicly communicate on due diligence.

The actual adverse environmental and human rights impacts covered by the proposal are specified in an **Annex.** In addition, some large companies will be required to have a plan to ensure their business strategy is compatible with limiting additional global warming to 1.5 C in line with the Paris Agreement.
In terms of the scope, the new due diligence rules will apply to the following companies and sectors:

EU companies:

Group 1: all EU limited liability companies of substantial size and economic power, defined as having 500+ employees and EUR 150 million+ in net turnover worldwide. The Commission estimates there are about 9,400 companies in this group.

- **Group 2:** Other limited liability companies operating in defined high impact sectors (e.g. textiles, agriculture, extraction of minerals), which do not meet the Group 1 thresholds, but have more than 250 employees and a net turnover of EUR 40 million worldwide. For these companies, rules will start to apply two years later than for group 1. The Commission estimates there are about 3,400 companies in this group.

- **Non-EU companies** with turnover generated within the EU that meet the threshold of Group 1 and Group 2. The Commission estimates, this would affect around 2,600 companies in Group 1 and around 1,400 in Group 2.

Small and medium enterprises (SMEs) do not fall directly within the scope of this proposal. Nevertheless, as they might indirectly be affected by the new rules through the large companies› actions across their value chains, the proposal foresees specific support measures for SMEs, such as guidance and other tools to help them gradually integrate sustainability considerations in their business operations.

The Directive also introduces **duties for the directors** of the EU companies that it covers. These duties include setting up and overseeing the implementation of the due diligence processes and integrating due diligence into the corporate strategy. In addition, when directors act in the interest of the company, they must take into account the human rights, climate and environmental consequences of their decisions and the likely consequences of any decision in the long term. Companies have to duly take into account the fulfilment of the obligations regarding the corporate climate change plan when setting any variable remuneration linked to the contribution of a director to the company's business strategy and long-term interests and sustainability.

In terms of **enforcement**, the proposal foresees that national administrative authorities appointed by member states would be responsible for supervising these new rules and may impose fines in case of non-compliance. However, the rules of directors' duties are to be enforced through existing national laws.

The Directive also requires member states to adapt their rules on civil liability to cover cases where damage results from failure by a company to comply with due diligence obligations, building on their existing regimes on civil liability.
"Our proposal will make sure that big market players take a leading role in mitigating the risks across their value chains while supporting small companies in adapting to changes," said Thierry Breton, Commissioner for the Internal Market.

In terms of the next steps, the proposal will be subject to the ordinary legislative process. The Commission presented the proposal to the Competitiveness Council on 24 February and the Legal Affairs Committee, which will lead on the file for the European Parliament, will hold an exchange of views with Commissioner Reynders on 28 February. The Competitiveness Council is also expected to address the issue again in its meeting on 9 June. Once adopted, member states will have two years to transpose the directive into national law and communicate the relevant texts to the Commission.

Political reaction

European Parliament

The Parliament had already set out its position on the issue in a **resolution** on sustainable corporate governance by the French Liberal MEP Pascal Durand published in December 2020 and a complementary **legislative initiative report** on corporate due diligence and corporate accountability, by the Dutch centre-left MEP Lara Wolters in March 2021. She also **called** for additional measures, including a ban on importing products linked to severe human rights violations such as forced or child labour, which the Commission addressed in a separate Communication on decent work worldwide which was also published on 23 February.

In addition, a Parliamentary Working Group on Responsible Business Conduct has been highly engaged on the issue and has repeatedly called for the Commission to come forward with an ambitious proposal. In general, the Commission's proposal was warmly received by the different parliamentary groups.

Prior to the publication of the proposal, the largest group in the Parliament, the centre-right EPP **indicated** its support in principle, noting that "binding due diligence obligations are an important step towards companies assuming more responsibility in their value chains with regard to the protection of human rights and the environment". The party also said it supported an exemption for SMEs and a risk-based approach, which it argued would help prevent unnecessary reporting obligations.

Speaking on behalf of the centre left S&D, Wolters **welcomed** the proposal, saying that responsible business conduct must become the norm in the EU. "With countries like France and Germany already pressing ahead with their own rules, the EU risks being behind the curve when it comes to protecting people and the planet, rather than short-term profits," she said in a statement. She also **tweeted** "Citizens, employees, consumers, investors and shareholders are all demanding businesses to become more sustainable. Doing business in 2022 must mean doing business responsibly. Today's **#duediligence** proposal is the first step towards that".

The Greens also **welcomed** the proposal, labelling it a "landmark step towards implementing the United Nations Guiding Principles on Business and Human Rights. It is a victory that all major companies operating within the EU will be obliged to ensure respect for human rights and the environment in their global value chains". Speaking on their behalf, the Finnish MEP, Heidi Hautala argued that "the proposal encompasses the whole value chain and includes clear liability provisions, which sends a strong signal to the global market that the EU wants to see a substantive and lasting change". She did, however, argue that model contract clauses were a "step in the wrong direction".

Bernd Lange, Chair of the INTA Committee in the Parliament, noted that "the risk-based approach to the exercise of due diligence is the right way to go. Companies must act and develop countermeasures according to the potential risk of violating labour rights and environmental standards. The mere size of a company is secondary; accordingly, it is right to define the scope of the legislation according to risk. The European Parliament will certainly attach particular importance to this aspect and, if necessary, further strengthen it."

Council of the European Union

The Council of the European Union has yet to react to the proposal, but on December 1, 2020, it adopted **conclusions** on "Human Rights and Decent Work in Global Supply Chains", calling on the Commission "to launch an EU Action Plan that is focusing on shaping global supply chains sustainably, promoting human rights, social and environmental due diligence standards and transparency". The Council also called on the Commission to update its 2006 Communication on "Promoting decent work for all – the EU contribution to the implementation of the decent work agenda in the world'. It also said member states should step up efforts to implement the UN Guiding Principles on Business and Human Rights, including through new or updated National Action Plans.

In its **programme** for the first half of 2022, the French Presidency of the Council of the European Union said it wanted to make Europe a leader in sustainable finance by prioritising work on a Corporate Sustainability Reporting Directive (CSRD) and highlighting the importance of the initiative on sustainable corporate governance.

Stakeholder Reaction

BusinessEurope, the corporate lobby group, indicated its support for the overall ambition of the Commission, but argued that "the aim to make supply chains more sustainable needs to be achieved in a way that is workable for companies and must not unilaterally make European companies responsible for factors way beyond their control". It said it was "unrealistic to expect that European companies can control their entire value chains across the world, including "indirect" third-party suppliers or even customers". Whilst it welcomed the exclusion of SMEs from the scope, it warned that the "inclusion of the financial sector bears the risk of unwanted effects and could cause another access to finance problem for the European real economy". BusinessEurope also said the "intrusion into the careful balance on directors' duties creates the risk to disrupt the primary function of boards, in accordance with national company laws".

EcoDa, which represents the interests of European board members, also **voiced** concern about directors' duties. It argued that "the proposal provides relatively little useful clarification on the notion of directors' duty of care... Streamlined and consistent environmental and social standards would be more useful than legislative texts which expand their responsibilities in an imprecise way". It said the decision to include director duties in the proposal means that companies could find themselves subject to litigation from any stakeholder and this "risks bringing business to justice in Europe and could make our companies even more risk-averse."

Eurometaux, the European metals association, was largely **in favour** of the proposal labelling it an "important milestone to strengthen Europe's due diligence system for all sectors". They did however stress the need for coherence with "overlapping EU policies like the Conflict Minerals Regulation and the upcoming Batteries Regulation, and relevant international frameworks such as the OECD and UN Guiding Principles".

EuroCommerce, which represents retail, wholesale, and other trading companies, recognised the importance of the issue of supply chain due diligence, but argued that "the nature of retail and wholesale means dealing with a constantly changing multiplicity of actors in highly differentiated, often global value chains" and called for this to be taken into account by ensuring that the legislation "provides clear definitions and a proportionate allocation of responsibilities." EuroCommerce also sought to limit the potential liability of their members arguing that their sector can "only have limited impact and leverage beyond the own-brand products it sources directly and in ensuring that tier-1 suppliers respect the rules and can give reliable assurances that they demand the same from their suppliers".

BDI, the Organisation of German Industry, warned against overwhelming companies, arguing that it was wrong to shift the responsibility for protecting human rights and the environment onto companies. It said applying the regulations across the entire value chain – including the downstream stages – was unrealistic and called for mandatory legal requirements to be limited to the direct suppliers in order to be implementable in daily practice.

VDMA, the German Association of Mechanical Engineers, took a **sceptical approach** to the proposal, arguing that it "goes too far and will not be implementable by many companies in the mechanical engineering sector - especially if it also includes customers". They argued that the proposal would force European companies to withdraw from certain markets and this would have a detrimental environmental effect, as "climate and environmentally efficient technology from European companies enabling safe and ergonomic work would no longer be available in these markets". It called for the scope to be limited to the actual company in question, its subsidiaries and its direct suppliers.

BEUC, the European Consumer Organisation, **argued** that "obliging companies to better vet their supply chains should ideally result in improved social, environmental and climate standards for all products we buy". They did however call for a more ambitious proposal that applies to all companies "operating or placing products on the EU market. The EU should also include climate change in these due diligence requirements, as it currently only foresees social standards and the environment. Finally, to be effective, a law needs to be accompanied by a proper enforcement mechanism."

Finance Watch **welcomed** the aspects of mandatory corporate sustainability due diligence, but argued that the proposals were too limited in scope, given that 99% of EU companies would not be covered. It also called for environmental due diligence to refer to EU law and include climate-related considerations. It did however welcome that non-EU companies with significant EU operations were included in the scope of requirements, arguing that this would encourage a level-playing field for the EU companies. On the question of directors' duties, Finance Watch criticised the lack of ambition in the proposals and also called for an alignment of half of directors' bonuses with corporate sustainability targets, arguing that this would put financial and sustainability-related objectives on an equal footing and set companies on a path towards sustainability.

Oxfam said the legislation does not go far enough, **arguing** that the proposal "is a far cry from what is needed to protect people and the planet from irresponsible business practices". Noting that the proposal would apply to only 1 percent of European companies, Oxfam called for an expansion of the scope to ensure that "all companies, not just the biggest, (are) responsible for their human rights or environmental violations and for damage to the climate". They also criticized the lack of rules on directors' duties and remuneration, claiming that the proposal is "too weak to ensure directors will look beyond immediate financial returns and take into consideration human rights, the environment and the climate when making strategic decisions."

Friends of the Earth Europe **said** the EU law to stop corporate abuse failed to guarantee justice or make companies liable for the climate impacts. While it supported the ambition of the Commission, it argued that it leaves "gaping loopholes that will allow corporations to escape liability by claiming they have met their obligations despite not taking real action to stop harms". The concept of 'contractual assurances' falls well short of what true liability would entail, it said.

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customer.service@dodsgroup.com
or +44 207 593 5500

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Registered office:
11th Floor, The Shard
32 London Bridge Street
London SE1 9SG