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EU Commission Proposal—Corporate Sustainability Due Diligence Directive

Briefing Note No. 2

Introduction

In a watershed moment, the European Union has made it clear that human rights due diligence will move from ‘advised’ to ‘required’. Our clients in Europe and the US are looking to understand how the proposed CSDD will affect them and want to understand what leadership in business and human rights will look like in the future. This Briefing Note provides answers to our clients’ most pressing questions on the proposal. In our Briefing Note No. 1, we outlined key steps to prepare for mandatory human rights due diligence. Here, we are updating on the newly published EU Commission proposal for a Corporate Sustainability Due Diligence Directive (CSDD).

What are the Key Takeaways?

Underpinned by mechanisms of accountability, the proposal moves beyond both voluntary and reporting style initiatives. Larger EU companies, as well as non-EU companies with turnover generated in the EU, will be required to conduct human rights and environmental due diligence. Two years after the Directive comes into force, expected in 2026, the rules will extend to smaller companies operating in defined ‘high-impact’ sectors. These companies will have to put in place a due diligence process, and take actions regarding preventing, mitigating, minimizing and bringing to an end both potential or actual adverse impacts on the rights and prohibitions in international human rights agreements and selected environmental conventions. For EU companies, directors are involved, with duties including to set up and implement the due diligence process and integrate due diligence into the corporate strategy.

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The proposed Directive is more ambitious than existing due diligence laws

In addition, large EU and non-EU companies coming within scope need to have a plan in place to ensure that their business strategy is compatible with transition to a sustainable economy and with the limiting global warming in line with 1.5 degrees Celsius in the Paris Agreement.

Why is the EU proposing the Directive?

The EU is committing to advancing the benefits of responsible business conduct and safeguarding the environment. In addition, there is a need for a harmonizing EU level framework to prevent fragmentation

ABOUT ARTICLE ONE

Article One is a specialized strategy and management consultancy with expertise in human rights, responsible innovation, and social impact. We partner with the world’s leading companies to drive transformative change that places people at the center of business.

and limit differing rules across the EU. As it stands, France, [Germany](#) and [Norway](#) have already passed due diligence style laws, and there are [legislative developments](#) in multiple other European states. In Europe, there is public support for greater corporate sustainability and accountability. In the run up to publication of the proposed Directive, public commitments of support were made by [businesses](#) and [industry](#) across sectors, as well as [investors](#). Both [citizen polls](#) and the public consultation were overwhelmingly supportive. Concurrently, business is responding to changed expectations, with many companies moving to adopt robust due diligence policies.

When will the Directive come into force?

Firstly, this is not the final iteration of the Directive. It now progresses through the EU law-making process with significant momentum behind the EU institutions arriving at an agreed final version in 2022/23. This timing would imply an EU level framework transposed into law in Member States by 2026.

Who will the proposed Directive apply to?

The Directive may apply directly, indirectly, or be part of your company's commitment to implement the UN Guiding Principles on Business and Human Rights. Your company may come within scope due to size or sector, or indirectly because companies you deal with would come within scope, or because it is consistent with your company's commitment and ambition to adopt leading practices.

According to the Commission, in '**Group 1**', around 9,400 EU companies which have over 500 employees and net worldwide turnover over EUR 150 million in the last financial year would come within its scope.

Including third country companies is crucial to promoting a level playing field, and about 2,600 non-EU companies with net turnover of over EUR 150 million in the EU in the last financial year are expected to come within.

Two years later, in '**Group 2**', the rules would extend to include around 3,400 EU companies with over 250 employees on average and over EUR 40 mln. net worldwide turnover in the last financial year, provided at least 50% of this turnover was generated in one or more of three defined 'high impact' sectors being textiles, agri-food and extraction of minerals.¹ Around 1,400 non-EU companies with over

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Your company may come within directly, or indirectly via trading partners, or because of your commitment to implementing leading practices

¹ Manufacture of textiles, leather and related products (including footwear) and 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; 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-

EUR 40 million EU wide net turnover, if at least 50% of this net turnover was in these high impact sectors, would also come within scope.² Non-EU companies are not subject to the employee threshold. Already, discussion is highlighting the exclusion of sectors such as technology and promoting including related issues such as deforestation. Notably, and already criticized, exceptions to obligations are introduced for financing and parts of the financial sector where due diligence is only required prior to facilities rather than over their lifetime.

Which parts of our operations will the proposed Directive cover?

The proposal introduces duties for companies within its scope to undertake due diligence for actual or potential adverse human rights and environmental impacts in companies’:

- own operations,
- their subsidiaries and
- their value chains (direct and indirect established business relationships), wherever located.

In practice, companies not within scope could be drawn into due diligence due to the emphasis on contractual cascading within the proposal. Where relevant, companies are to obtain contractual assurances from their direct suppliers that they will both abide by its code of conduct, and in turn cascade contractual assurances to business partners down the value chain. While companies must verify compliance, this may be done via industry schemes or third parties. As has happened before, if verification is not effective, there can be tragic consequences. The contractual cascading approach is controversial. It diverges from the focus in the UN Guiding Principles on Business and Human Rights (UNGPs) on preventing harm occurring, for companies to prioritize on the basis of severity of risks to others, and on the connection or linkage between its operations and avoidable harm.

What are the due diligence requirements in the proposed Directive?

Due diligence would extend over companies’ own operations, subsidiaries, and ‘established’ direct and indirect business relationships across their value chain, wherever located. Both upstream and downstream activities related to production of goods and services are part of the value chain. A concept of ‘established’ business relationships is introduced. These are defined as direct or indirect business relationships ‘which are expected to be lasting in view of their intensity or duration’, even the parties are not in a direct contractual relationship. This concept is being criticised for lack of clarity, excluding short-term business relationships which could have adverse impacts, and the potential to game by actively switching between suppliers.

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).

² Micro companies and SMEs, which are the vast majority of companies in the EU, are not included in scope. Provision to review in Article 29.

The Directive would require companies within its scope:

- **Due diligence policy** - to have in place a due diligence policy, which is updated annually including a code of conduct to be followed by the company's employees and subsidiaries;
- **Identify actual or potential adverse human rights and environmental impacts** - an obligation on companies in their own operations, in their subsidiaries and at the level of their established direct or indirect business relationships in their value chain³;
- **Prevent potential adverse impacts**; or,
- **Mitigate potential adverse impacts** - where prevention is not possible, or not immediately so, adequately mitigate potential adverse impacts that have or should have been identified above;
- **Bring to and end or minimise actual adverse impacts** - take appropriate measures to bring to an end or minimise actual adverse impacts that have, or should have been identified above;
- **Complaints mechanism** – companies must establish and maintain a complaints procedure for potential or actual adverse impacts, including in the company's value chain;
- **Monitor effectiveness** - at least annually, companies should monitor the effectiveness of the the identification, prevention, mitigation, bringing to an end and minimisation of the extent of human rights and environmental adverse impacts; of their own operations and measures, those of their subsidiaries and, where related to the value chains of the company those of their established business relationships. The due diligence policy is to be updated in accordance with the outcome of those assessments; and
- **Report and publicly communicate** - annually on matters under the Directive and publish an annual statement on their website.

For Preventing and mitigating potential adverse impacts, the actions companies should take, where relevant, include amongst others:

- develop and implement a prevention action plan in consultation with affected stakeholders;
- seek contractual assurances from a business partner with whom it has a direct business relationship that it will ensure compliance with the company's code of conduct and, as necessary, a prevention action plan, including contractual cascading, and accompanied by appropriate measures to verify compliance, for which the company may refer to suitable industry initiatives or independent third-party verification;

³ Where relevant, also carry out consultations with potentially affected groups including workers and other relevant stakeholders to gather information on actual or potential adverse impacts. For companies having turnover in 'high impact' sectors, identify impacts relevant to that sector. Companies which provide credit, loan or financial services need to identify actual and potential adverse impacts prior (only) to providing these services.

- making make necessary investments, such as into management or production processes and infrastructures, to comply with obligation to prevent and mitigate.

For bringing **actual adverse impacts identified an end**, the actions companies should take, where relevant, include amongst others:

- neutralise or minimise its extent including by financial compensation to those affected;
- if the adverse impact cannot be immediately be brought to an end, developing a corrective action plan, with timelines and indicators. Where relevant, the corrective action plan shall be developed in consultation with stakeholders;
- seek contractual assurances from a direct partner with whom it has an established business relationship that it will ensure compliance with the code of conduct and, as necessary, a corrective action plan, including contractual cascading and accompanied by the appropriate measures to verify compliance;
- making make necessary investments, such as into management or production processes and infrastructures to comply.

Regarding actual adverse impacts that could not be brought to an end, or the extent of which could not be minimised by the measures outlined, the company shall not extend the relationship, and shall:

- temporarily suspend commercial relations with the partner in question while pursuing efforts to bring to an end or minimise the extent of the adverse impact, or
- terminate the business relationship with respect to the activities concerned if the adverse impact is severe.⁴

What types of impacts does the Directive apply to?

As the EU Commission states: 'In order to achieve a meaningful contribution to the sustainability transition, due diligence under this Directive should be carried out with respect to all adverse human rights and environmental impacts identified in its [Annex](#)'⁵

- **An 'adverse human rights impact'** means an adverse impact on protected persons resulting from the violation of one of the rights or prohibitions listed in the Annex, Part I Section 1, as enshrined in the international conventions listed in the Annex, Part I Section 2;
- **An 'adverse environmental impact'** means an adverse impact on the environment resulting from the violation of one of the prohibitions and obligations pursuant to the international environmental conventions listed in the Annex, Part II.

⁴ Requirement does not apply to financing facilities where this can be reasonably expected to cause substantial prejudice to the financed entity.

⁵ [Q&A: Proposal for a Directive on corporate sustainability and due diligence.](#)

The [Annex](#) sets down the scope of adverse human rights and environmental impacts, listing violations and prohibitions in international human rights agreements and standards, such as on labour rights, civil rights and the rights of the child. Separately, violations of internationally recognised objectives and prohibitions included in selected, limited, environmental conventions are listed. The span of violations and prohibitions, as well as international human rights agreements and environmental conventions referenced, goes well beyond those included in existing due diligence laws. The proposed Directive refers to core standards such as the ICCPR, ICESCR and ILO Conventions and advances further. For example, concerning children it includes the prohibitions against child labour and the worst forms of child labour and violations of rights contained in the Convention on the Rights of the Child.

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The types of impacts covered by the Directive go beyond those included in existing due diligence laws

What new Directors' duties and responsibilities are introduced?

For EU companies (Group 1 and 2), a Directors' Duty of Care is introduced. Directors acting in the interests of the company would have to consider the human rights, climate and environmental consequences of their decisions through to the long term. Member States are to ensure that their laws, regulations and administrative provisions providing for a breach of directors' duties also apply to this provision. Directors would be responsible for putting in place and overseeing the implementation of a due diligence policy and actions 'with due consideration for relevant input from stakeholders and civil society organisations', and report to the board on it. If directors' variable remuneration is linked to their contribution to long-term sustainability, this should take into account fulfilling their corporate climate change plan.

How would the Directive be enforced?

Accountability within the Directive includes administrative sanctions and civil liability. Fines are linked to turnover, but as levels are unspecified there is the potential for divergence across Member States. If implemented in practice, the provisions for enforcement by competent national authorities appear to be adequate. Overall, due diligence is an 'obligation of means',⁶ but the design aims to make it difficult for companies to assert they were not aware of adverse impacts, as the requirements upon adverse impacts which have been, or should have been, identified in line with a company's obligations under the Directive. States would be obliged to provide for civil liability if a company fails to comply with due diligence obligations and, as a result, an adverse impact leads to damage. However, it is in turn linked to actions taken on contractual cascading and verifying compliance, and their reasonableness in the specific circumstances, to prevent, mitigate, minimise or end the harm. Civil liability is welcome and

⁶ Preamble 15.

crucial for remedy, but the proposal lacks necessary supports to overcome existing barriers faced by those negatively impacted.

Are there key gaps in the current proposal?

Increasing stakeholder engagement is amongst aspects which may change in the final version. While threaded into the proposal, the provisions lack the breadth and weight in the UNGPs and EU Parliament [Recommendations](#). Greater emphasis is required on safe engagement with stakeholders, including vulnerable populations and those at increased risk including migrant workers and women. The final version would be improved by greater focus on ‘severity’ of risks to others, in line with the UN Guiding Principles on Business and Human Rights. We would welcome increased focus on embedding prevention of harm in the first place within business, and less on external verification of compliance. The contractual cascading concept which has been introduced is tricky, and invites disputes or litigation

Where might the final version come in?

The final span of the EU Corporate Sustainability could be greater in two principal ways. Firstly the EU Parliament presses for more comprehensive provisions akin to its recommendations of March 2021. Secondly, as a Directive, it will provide a minimum framework. This is a ‘floor’, but individual Member States can go further when enacting national law. Further, existing national laws and legislative proposals will in time have to align, at minimum, with the final version.

What should our company do to prepare?

Companies can prepare by assessing whether they are likely to come within the scope, and in what geographies. They can then commence the process of mapping whether their existing due diligence policy and processes align with the Directive and other standards via a gap analysis. Proactively preparing will strengthen the company, enabling it to adopt best practice and to be ready for this and other forthcoming legislation proactively.

How can Article One help to prepare?

We can provide detailed guidance, perform gap analysis to benchmark your policies and processes against the EU proposal and other existing laws. We are enabling our clients to develop a roadmap for alignment, and assisting our clients to strengthen and ‘future-proof’ their policies and processes. We can help develop strategies which work forward and build robust approaches which reflect your company’s values, ambition and strategic goals.

Dr Rachel Widdis, Director EMEA, Article One

For more information, including the Article One Regulatory Briefing on Due Diligence Laws in Europe, contact rachel@articleoneadvisors.com.