



RESPECT FOR HUMAN RIGHTS AND THE ENVIRONMENT

On 23 February 2022 the European Commission (EC) proposed rules for companies to respect human rights and the environment in global value chains. This proposal is in the form of a Directive and an associated annex on corporate sustainability due diligence (the proposal).¹

The proposal aims to foster sustainable and responsible corporate behaviour throughout global value chains. Companies will be required to identify and, where necessary, prevent, end, or mitigate adverse impacts of their activities on human rights, such as child labour and exploitation of workers, and on the environment, for example pollution and biodiversity loss.

The EC says that for businesses these new rules will bring legal certainty and a level playing field, whilst for consumers and investors they will provide more transparency.

The journey so far

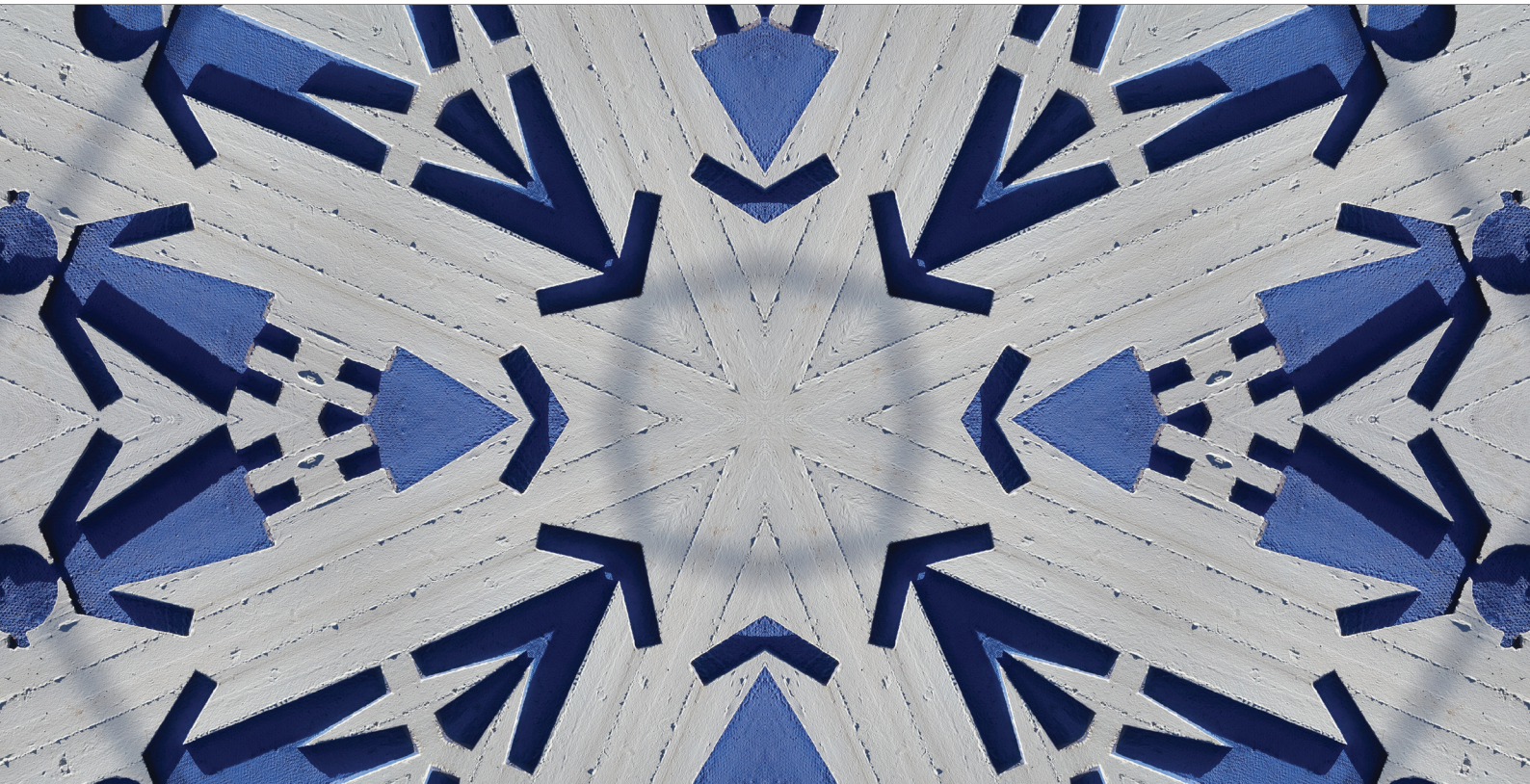
Many companies are already putting in place corporate sustainability tools. For instance, research undertaken for the EC and published in the 2020 study on due diligence requirements through the supply chain² showed that a third of surveyed companies, across all sectors, said that their companies undertake work in this area, considering all human rights and environmental impacts. The EC says that such own commitments or voluntary initiatives are laudable and have helped tackle sustainability problems to a certain extent. However, the research also showed that when companies take voluntary action, they focus on the first link in the supply chain while human rights and environmental harm occurs more often further down in the extended supply chain.

Despite these actions, progress remains slow and uneven, so the EC feels that there is need for a larger scale improvement that has been difficult to achieve with voluntary action.

Value chains

Article 3 of the proposal provides a definition of 'value chain' which the EC describes as:

"Activities related to the production of goods or the provision of services by a company, including the development of the product or the service and the use and disposal of the product as well as the related activities of upstream and downstream established business relationships of the company. As regards companies within the meaning of point (a) (iv), 'value chain'



with respect to the provision of these specific services shall only include the activities of the clients receiving such loan, credit, and other financial services and of other companies belonging to the same group whose activities are linked to the contract in question. The value chain of such regulated financial undertakings does not cover SMEs receiving loan, credit, financing, insurance or reinsurance of such entities.”

This definition is very broad as the EC appreciates that European Union (EU) companies operate in complex surroundings and, especially large ones, rely on global value chains.

Such information will be difficult to obtain in some cases, but again, the EC acknowledges that identifying any ‘adverse impacts’³ in value chains will become easier if more companies exercise due diligence, making more data available.

The proposal recitals further expand on what the EC means by value chains which should cover activities related to the production of a good or provision of services by a company, including the development of the product or the service and the use and disposal of the product as well as the related activities of established business relationships of the company.

It should encompass upstream established direct and indirect business relationships that design, extract, manufacture, transport, store and supply raw material, products, parts of products, or product services to the company that are necessary to carry out the company’s activities, and also downstream relationships, including established direct and indirect business relationships, that use or receive products, parts of products or services from

that company up to the end of life of the product, including inter alia the distribution of the product to retailers, the transport and storage of the product, dismantling of the product, its recycling, composting or landfilling.

Who is impacted?

The proposal will apply to the following companies and sectors:

- EU companies:



Group 1: All EU limited liability companies of substantial size and economic power with 500+ employees and EUR 150 million+ in net turnover worldwide.



Group 2: Other limited liability companies operating in defined high impact sectors, which do not meet both Group 1 thresholds, but have more than 250 employees and a net turnover of EUR 40 million worldwide and more. For these companies, rules will start to apply 2 years later than for Group 1.

- Non-EU companies active in the EU with turnover threshold aligned with Group 1 and 2, generated in the EU.
- Small and medium enterprises (SMEs) are not directly in the scope of this proposal.

This proposal applies to the company’s own operations, their subsidiaries, and their value chains (direct and indirect established business relationships).

The proposal provides a full explanation of what constitutes ‘a company’ in the form of a definition at Article 3. A company can include the following, amongst others:

- An EU or third country legal person, or a legal person constituted in accordance with Annex II to Directive 2013/34/EU;
- A regulated financial undertaking which could include a credit institution or an investment firm;
- An AIFM of a EuVECA, EuSEF, or ELTIF;
- A UCITS management company;
- An AIF, managed by an AIFM;
- UCITS as per Article 1(2) of the UCITS Directive;
- An insurance undertaking;
- An Institutions for Occupational Retirement Provisions (IORP);
- Pension institutions operating pension schemes considered to be social security schemes; and
- Central counterparty.

A full list of companies captured can be found on pages 47-51 of the proposal.

How the proposal interacts with other legislation in the sustainable space

At the EU level, sustainable corporate governance has mainly been covered by imposing reporting requirements in the Non-Financial Reporting Directive (NFRD). This will in turn be revised by the Corporate Sustainability Reporting Directive (CSRD).

The proposal will add a substantive corporate duty for some companies to perform due diligence to identify, prevent, mitigate and account for external harm resulting from adverse human rights and environmental impacts in the company's own operations.

The proposal will also underpin, complement, or amend the following pieces of legislation:








- *Underpin* the Sustainable Finance Disclosure Regulation (SFDR);
- *Complement* the Taxonomy Regulation (TR);
- *Amend* the Annex of the EU Whistleblowing Directive⁴ to include the proposed Directive;
- *Complement* the Directive on preventing and combating trafficking in human beings and protecting its victims;⁵ and
- *Complement* the Employers' Sanctions Directive.⁶

There are also other existing or planned sectoral and product-related value chain due diligence instruments at the EU level which the proposal will complement. Details of these can be found in the proposal on pages 6-10.

What is required?

The proposal sets out a corporate due diligence duty to identify, prevent, end, mitigate and account for adverse human rights and environmental impacts in the company's own operations, its subsidiaries, and their value chains. It builds on the UN's Guiding Principles on Business and Human Rights⁷ and OECD Guidelines for Multinational Enterprises and responsible business conduct,⁸ and is in line with internationally recognised human rights and labour standards.

To comply with the corporate due diligence duty, companies need to:

-  Integrate due diligence into 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; and
-  Publicly communicate on due diligence.

The EC say this means more effective protection of human rights as included in international conventions. For example, workers must have access to safe and healthy working conditions.

Similarly, the EC say that this proposal will help to avoid adverse environmental impacts contrary to key environmental conventions.

Companies in scope will need to take appropriate measures ('obligation of means'), in light of the severity and likelihood of different impacts, the measures available to the company in the specific circumstances, and the need to set priorities.

In order to achieve a meaningful contribution to the sustainability transition, due diligence under this proposal should be carried out with respect to all adverse human rights and environmental impacts identified in its 6-page Annex.⁹ This means that companies must take appropriate measures to prevent, end or mitigate impacts on the rights and prohibitions included in international human rights agreements, for example, regarding workers' access to adequate food, clothing, and water and sanitation in the workplace. Companies are also required to take measures to prevent, end or mitigate negative environmental impacts that run contrary to a number of multilateral environmental conventions.



Enforcement of the new rules

In terms of administrative supervision, Member States (MS) will designate an authority to supervise and impose effective, proportionate, and dissuasive sanctions, including fines and compliance orders.

Then at a European level the EC will set up a European Network of Supervisory Authorities that will bring together representatives of the national bodies to ensure a coordinated approach.

As regards civil liability, MS will ensure that victims get compensation for damages resulting from the failure to comply with the obligations of the proposal.

In addition, Group 1 companies need to have a plan to ensure that their business strategy is compatible with limiting global warming to 1.5 °C in line with the Paris Agreement.¹⁰

Senior accountability and remuneration

To ensure that due diligence becomes part of the whole functioning of companies, directors of companies will need to be involved. Therefore, the proposal also introduces directors' duties to set up and oversee the implementation of due diligence and to integrate it into the corporate strategy.

In addition, when fulfilling their duty to act in the best interest of the company, directors must consider the human rights, climate change and environmental consequences of their decisions.

Where companies' directors enjoy variable remuneration, they will be incentivised to contribute to combating climate change by reference to the corporate plan.

Help for companies

The proposal also includes accompanying measures, which will support all companies, including SMEs, that may be indirectly affected.

Measures include the development of individually or jointly dedicated websites, platforms or portals and potential financial support for SMEs.

To provide support to companies the EC may adopt guidance, including about model contract clauses. The EC may also complement the support provided by MS with new measures, including helping companies in third countries.

International commitments

The aim of the proposal is to ensure that the EU, including both the private and public sectors, acts on the international scene in full respect of its international commitments in terms of protecting human rights and fostering sustainable development, as well as international trade rules.

As part of its 'Just and sustainable economy package' the EC also presented, on 23 February 2022, a Communication on Decent Work Worldwide¹¹ which sets out the internal and external policies the EU uses to implement decent work worldwide, putting this objective at the heart of an inclusive, sustainable, and resilient recovery from the pandemic.

THE PROPOSAL IN MORE DETAIL

Directive on Corporate Sustainability and Due Diligence	
Article 1	Sets out the subject matter of the proposed Directive, i.e., laying down rules on the due diligence obligations of companies regarding actual and potential human rights and environmental adverse impacts, with respect to their own operations, the operations of their subsidiaries, and the value chain operations carried out by established business relationships; the provision also specifies that the proposed Directive establishes rules on liability for violations of the due diligence obligation.
Article 2	Establishes the personal scope of application of the proposed Directive and sets out the criteria based on which a MS is competent to regulate matters covered in the proposed Directive.
Article 3	Contains definitions for the purpose of the proposed Directive.
Article 4	Requires MS to ensure that companies conduct human rights and environmental due diligence by complying with the specific requirements listed in Articles 5 to 11 of the proposed Directive.
Article 5	Requires MS to ensure that companies integrate due diligence into all corporate policies and have in place a due diligence policy that is updated annually. The provision specifies that this policy should include a description of the company's approach to due diligence, of a code of conduct to be followed by the company's employees and subsidiaries, of the processes put in place to implement due diligence.
Article 6	Establishes the obligation for MS to ensure that companies take appropriate measures to identify actual or potential adverse human rights and environmental impacts in their own operations, in their subsidiaries and at the level of their established direct or indirect business relationships in their value chain.
Article 7	Sets out the requirement for MS to ensure that companies take appropriate measures to prevent potential adverse impacts identified pursuant to Article 6, or to adequately mitigate those impacts, where prevention is not possible or requires gradual implementation.
Article 8	Establishes the obligation for MS to ensure that companies take appropriate measures to end actual adverse human rights and environmental impacts that they had or could have identified pursuant to Article 6. Where an adverse impact that has occurred at the level of established direct or indirect established business relationships cannot be ended, MS should ensure that companies minimise the extent of the impact.
Article 9	Sets out the obligation for MS to ensure that companies provide for the possibility to submit complaints to the company in case of legitimate concerns regarding those potential or actual adverse impacts, including in the company's value chain. Companies are required to grant this possibility to persons who are affected or have reasonable grounds to believe that they might be affected by an adverse impact, to trade unions and other workers' representatives representing individuals working in the value chain concerned, and to civil society organisations active in the area concerned.
Article 10	Introduces the obligation for MS to require companies to periodically assess the implementation of their due diligence measures to verify that adverse impacts are properly identified and that preventive or corrective measures are implemented, and to determine the extent to which adverse impacts have been prevented or brought to an end or their extent minimised.
Article 11	Establishes the obligation for MS to ensure that companies that are not subject to reporting requirements under Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings report on the matters covered by the proposed Directive and publish an annual statement on their website.
Article 12	Sets out the obligation for the EC to adopt guidance about non-binding model contract clauses to help companies comply with Article 7(2), point (b), and Article 8(3) point (c).
Article 13	Sets out the possibility for the EC, in order to provide support to companies or to MS authorities on how companies should fulfil their due diligence obligations, to issue guidelines, for specific sectors or specific adverse impacts, in consultation with the European Union Agency for Fundamental Rights, the European Environment Agency, and where appropriate with international bodies having expertise in due diligence.
Article 14	Requires the MS and EC to provide accompanying measures to companies in the scope of the proposed Directive actors and to actors along global value chains that are indirectly impacted by the obligations of the proposed Directive. Such support can range from the operation of dedicated websites, portals, or platforms to financial support to SMEs, and facilitation of joint stakeholder initiatives. This provision further clarifies that companies may rely on industry schemes and multi-stakeholder initiatives to support the implementation of due diligence and that the EC, in collaboration with MS, may issue guidance for assessing the fitness of such schemes.
Article 15	Requires the MS ensure that certain 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.

THE PROPOSAL IN MORE DETAIL

Directive on Corporate Sustainability and Due Diligence	
Article 16	Introduces the requirement for companies formed in accordance with the legislation of a third country and falling within the scope of application of the proposed Directive pursuant to Article 2(2), to designate a sufficiently mandated authorised representative in the EU to be addressed by MS' competent authorities, on all issues necessary for the receipt of, compliance with and enforcement of legal acts issued in relation to the proposed Directive.
Article 17	Sets out the requirement for MS to designate one or more national supervisory authorities to ensure compliance by companies with their due diligence obligations and their obligation under Article 15(1) and (2) and to exercise the powers of enforcement of those obligations in accordance with Article 18.
Article 18	Sets out the appropriate powers and resources of the supervisory authorities designated by the MS to carry out their tasks of supervision and enforcement.
Article 19	Establishes the requirement for MS to ensure that any natural or legal person that has reasons to believe, based on objective circumstances, that a company does not appropriately comply with the provisions of the proposed Directive, is entitled to submit substantiated concerns, in particular in the MS of his or her habitual residence, registered office, place of work or place of the alleged infringement, to the supervisory authorities.
Article 20	Sets out that MS shall lay down rules on sanctions applicable to infringements of the national provisions adopted pursuant to the proposed Directive and shall take all measures necessary to ensure that they are implemented. The sanctions shall be effective, dissuasive, and proportionate. MS shall ensure that decision of the supervisory authorities containing sanctions related to the breach of the provisions of the proposed Directive should be published.
Article 21	Introduces a European Network of Supervisory Authorities composed by the representatives of the supervisory national authorities referred to in Article 16, with the aim to facilitate and ensure the coordination and alignment of regulatory, investigative, sanctioning, and supervisory practices, and the sharing of information among these supervisory authorities.
Article 22	Sets out the requirement for MS to lay down rules governing the civil liability of the company for damages arising due to its failure to comply with the due diligence obligations under specific conditions. It also introduces the obligation for Member States to ensure that the liability provided for in paragraphs 1 to 3 of this Article is not denied on the sole ground that the law applicable to such claims is not the law of a MS.
Article 23	Establishes the application of Directive (EU) 2019/1937 ¹² on the protection of persons who report breaches of European Union law, to the reporting of all breaches of the proposed Directive and the protection of persons reporting such breaches.
Article 24	Clarifies conditions of public support for companies.
Article 25	Clarifies directors' duty of care.
Article 26	Lays down the duty for directors of EU companies to set up and oversee the implementation of corporate sustainability due diligence processes and measures and to adapt the corporate strategy to due diligence.
Articles 27-32	Amends the Annex of Directive (EU) No 2019/1937 to include the proposed Directive; sets out the rules concerning delegated acts; contains a provision on the review of the proposed Directive; contains provisions on the transposition of the proposed Directive; sets the date of when the proposed Directive enters into force and sets out the addressees of the proposed Directive.
Annex	Specifies the adverse environmental impacts and adverse human rights impacts relevant for the proposed Directive, to cover the violation of rights and prohibitions including the international human rights agreements (Part I Section 1), human rights and fundamental freedoms conventions (Part I Section 2), and the violation of internationally recognised objectives and prohibitions included in the environmental conventions (Part II).

Next steps

The proposal will be presented to the European Parliament and the Council for approval.

Once adopted, MS will have two years to transpose the Directive into national law and communicate the relevant texts to the EC.

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- ¹. Proposal for a Directive on corporate sustainability due diligence and annex | European Commission (europa.eu).
 - ². Study on due diligence requirements through the supply chain - Publications Office of the EU (europa.eu).
 - ³. The proposal provides definitions of both 'adverse environmental impacts' and 'adverse human rights impact'.
 - ⁴. (EU) No 2019/1937.
 - ⁵. Directive 2011/36/EU of the European Parliament and of the Council of 5 April 2011 on preventing and combating trafficking in human beings and protecting its victims and replacing Council Framework Decision 2002/629/JHA (OJ L 101, 15 April 2011, p.1).
 - ⁶. Directive 2009/52/EC of the European Parliament and of the Council of 18 June 2009 providing for minimum standards on sanctions and measures against employers of illegally staying third-country nationals (OJ L 168, 30 June 2009).
 - ⁷. https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf.
 - ⁸. <https://www.oecd.org/corporate/mne/responsible-business-conduct-matters.htm>.
 - ⁹. 1_2_183888_annex_dir_susta_en.pdf (europa.eu).
 - ¹⁰. The Paris Agreement is a legally binding international treaty on climate change, first adopted on 12 December 2015, entering into force on 4 November 2016.
 - ¹¹. Communication on decent work (europa.eu)
 - ¹². Otherwise referred to as the EU Whistleblowing Directive.



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