

VAN BAEEL & BELLIS



**EUROPEAN COMMISSION
PUBLISHES CORPORATE
SUSTAINABILITY DUE
DILIGENCE PROPOSAL**

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On 23 February 2022, the European Commission ("**Commission**") [published](#) its long-awaited proposal for a Directive on Corporate Sustainability Due Diligence ("**Proposal**"). If adopted, European Union and foreign large and medium-sized companies established or doing business in the European Union risk becoming subject to a broad set of rules aimed at identifying and mitigating adverse impacts on human rights and the environment in their supply chains.

Background

The Proposal forms part of the EU's [Green Deal](#) and follows other initiatives setting out sector-specific due diligence obligations. The Proposal also draws on the United Nation's Guiding Principles on Business and Human Rights, and the Organisation for Economic Co-operation and Development's Due Diligence Guidance for Responsible Business Conduct ("**OECD Guidance**"), the latter of which contains a six-step process to identify and address human rights and environmental risks. The Proposal does not include a ban on products of forced labour, as the Commission has [announced](#) a separate strategy to address the forced labour issue.

Affected EU and foreign companies

The Proposal applies to companies that are established under the laws of an EU Member State as well as companies established outside the European Union that generate a certain amount of turnover within the European Union, although

For EU companies, the proposed rules would apply if, during the previous financial year, the company had:

- (i) more than 500 employees on average and generated over EUR 150 million in net turnover ("**high-cap**"); or
- (ii) more than 250 employees on average and generated over EUR 40 million in net turnover ("**mid-cap**") and generated at least 50% of the past year's net turnover in one or more of the following high-risk sectors:
 - (a) manufacturing of textile, leather and related products or the wholesale of textile, clothing and footwear;
 - (b) agriculture, forestry, fisheries (including aquaculture), manufacturing of food products or the wholesale of agricultural raw materials, live animals, wood, food and beverages; or
 - (c) extraction of mineral resources including hydrocarbons, metal and mineral ores or the wholesale of mineral resources and intermediate products including metals, construction materials, fuels, and chemicals.

In addition, the proposed rules would apply to foreign companies that, in the previous financial year, generated:

- (i) more than EUR 150 million of global turnover within the European Union ("**foreign high-cap**"); or

(ii) more than EUR 40 million of global turnover within the European Union, provided that 50% of global turnover was generated in one of the three high-risk categories of sectors ("*foreign mid-cap*"), outlined with respect to EU companies above.

For foreign companies, no employee threshold applies. By limiting the application of the Proposal to EU and foreign high- and mid-caps ("*covered companies*"), the Commission intends to exempt small and medium-sized enterprises ("*SMEs*") from the due diligence requirements, which comprise 99% of EU companies.

SMEs as well as other businesses in the European Union and abroad could nonetheless be indirectly affected because covered companies' obligations would extend to their entire supply chains. Notably, to comply with their duties to prevent and mitigate adverse impacts, covered companies must seek contractual assurances from business partners with which covered companies have an "established relationship", including suppliers and customers, whether established in the EU or abroad, that play a lasting and important role in the covered company's value chain. The Proposal envisages model contractual clauses which covered companies may use to share the responsibility for complying with some of its due diligence obligations with business partners.

Main due diligence obligations

The Proposal envisages six main obligations that mirror the six-step due diligence process set out in the OECD Guidance. The goal of these obligations is to ensure that covered companies identify and mitigate adverse impacts on human rights and the environment throughout their supply chain. The Proposal defines "adverse impacts" as those on protected persons and the environment, resulting from, respectively, violations of international human rights and environmental agreements that are listed in the Annex to the Proposal, without defining what constitutes an "adverse impact".

The six proposed obligations would require a covered company to:

- (i) **integrate** due diligence into its corporate policy. The policy must describe the company's approach to due diligence, establish a code of conduct applicable to its employees and subsidiaries, as well as set out procedures to implement due diligence obligations;
- (ii) **identify** actual and potential adverse human rights and environmental impacts arising from its own operations and those of its subsidiaries. A lower standard applies for EU and foreign companies subject to the mid-cap, which must identify severe adverse effects in their supply chain;
- (iii) **prevent** potential adverse impacts by increasing its ability to respond to and mitigate adverse impacts. Covered companies must, inter alia, adopt a prevention plan and seek contractual guarantees that direct business partners will comply with its code of conduct and verify compliance;
- (iv) **stop or mitigate** adverse impacts by taking remedial action, such as paying damages to affected persons and/or implementing a corrective action plan. Covered companies must also suspend or end relationships with business partners responsible for adverse impacts;
- (v) **consider** and follow-up on legitimate concerns voiced by affected persons, trade unions and civil society organisations regarding actual or potential adverse impacts with respect to its operations, its subsidiaries, and its supply chain. To this end, covered companies must establish a complaints procedure;

(vi) **monitor** its operations for adverse impacts, by conducting yearly assessments of its operations and those of its subsidiaries, as well as business partners with which it has a long-standing relationship.

The Proposal also envisages placing a duty of care on the directors of those companies. EU Member States must legislate so that directors of covered companies that do not “take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term”, face a breach of their director’s duties.

The Proposal also envisages that EU and foreign companies subject to the high-cap “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”. If climate risks pose a “principal risk”, the company must include emission reduction objectives. However, the Proposal offers no guidance on what qualifies as a “principal risk”.

Risks of non-compliance

The Proposal envisages that public supervisory authorities in each EU Member State would enforce the due diligence obligations, and that privately-led enforcement through civil judicial proceedings before the courts of EU Member States would become available.

EU Member States must designate a supervisory authority having the power to investigate covered companies’ compliance with the new due diligence obligations. Investigations might be initiated by either the supervising authority or a complaint from natural or legal persons demonstrating “substantiated” concerns.

EU Member States must also ensure the civil liability of covered companies that fail to comply with their due diligence obligations and have not mitigated those failures. However, in principle, covered companies should not be liable for failing to prevent or cease adverse impacts caused by business partners with which they do not have an established relationship, provided appropriate due diligence measures were taken.

Looking ahead

The European Parliament and the Council will now scrutinise the Proposal before it may be adopted. While some issues are expected to attract opposition, we expect that the Proposal’s reduced scope and core obligations are likely to be included in the final text of the directive. If the current text is adopted, the Proposal envisages a period of two years for EU Member States to implement the obligations for EU and foreign companies subject to the high-cap, in contrast to a period of four years for rules applicable to EU and foreign companies subject to the mid-cap.

Lawyers to contact



Pablo Muñiz

Partner

pmuniz@vbb.com



Michel Bonne

Partner

mbonne@vbb.com



Isabelle Van Damme

Partner

ivandamme@vbb.com



Mats Cuvelier

Associate

mcuvelier@vbb.com

VAN BAEL & BELLIS

BRUSSELS

Glaverbel Building
Chaussée de La Hulpe 166
B-1170 Brussels, Belgium

Phone: +32 (0)2 647 73 50

Fax: +32 (0)2 640 64 99

GENEVA

26, Bd des Philosophes
CH-1205 Geneva
Switzerland

Phone: +41 (0)22 320 90 20

Fax: +41 (0)22 320 94 20

LONDON

5, Chancery Lane
EC4A 1BL London
United Kingdom

Phone: +44 (0)20 7406 1471