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EuropeanIssuers' Position Paper on the European Commission's Proposal for a Corporate Sustainability Due Diligence Directive (CS3D)

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EuropeanIssuers welcomes the Commission's proposal for a Corporate Sustainability Due Diligence Directive (CS3D), as it notes that European companies have been engaged for many years in putting CSR and responsible business conduct (RBC) at the heart of their strategies and operations. They present the highest level of sustainability related information compared to companies worldwide and have made strong commitments, notably to reduce their GHG emissions as well as to respect human rights and environment.

Nevertheless, first analysis of the Commission proposal raises several legal, practical, and operational difficulties which give rise to the following demands of EuropeanIssuers member companies:

I. The scope

Take into consideration the group dimension (article 5):

- **CSDDD introduces due diligence obligations only at legal entity level and does not specifically address the case of groups on a consolidated basis (article 5 and 15)**. As it stands, a parent company which does not meet the thresholds would not be required to establish a due diligence plan for its subsidiaries meeting the threshold. Depending on the way the group is organised, legal entities which are not in the same chain of control (e.g., sisters companies) would be required to establish potentially different due diligence plans. If these legal entities are registered in different member states, the plan would be set up according to the national legislation of their head offices which may vary to some extent.

  This approach contradicts the organisation of groups and would lead to a lack of efficiency and coherence. **CSR and due diligence policies are usually adopted at the parent company level**, which ensures their deployment throughout the group. The parent company plays an **essential role in the identification of risks and their management or mitigation**. Subsidiaries neither have the overall vision of the risks, and actions to be taken to manage them, nor do they systematically have **the legal competences to deal with complex matters such as due diligence obligations. Subsidiaries** would have to hire, and train dedicated teams which would **disproportionately increase the administrative burden, cost, and risk of litigation for each subsidiary.**

In addition, this approach is **not consistent with the CSRD proposal** which retains a consolidated approach. As these two initiatives are closely interrelated, a consistent approach is needed in order to avoid implementation difficulties.

Therefore, the proposal should be amended in order to take into consideration the notion of group and to clarify that:

- **when the parent company does not meet the required thresholds while several subsidiaries within the group meet the thresholds, the parent company may, on a voluntary basis, perform the obligations set out in articles 4 to 11 on behalf of those legal entities;**
- **when the parent company, together with one or several subsidiaries within the group, meets the thresholds, those subsidiaries are exempted from the obligations set out in articles 4 to 11 where these obligations are performed by their parent company.**

However, in both cases, this will not exempt these legal entities to effectively implement the due diligence in their processes.

- **Regarding climate change (article 15):** As climate change is a global issue, transition plans are defined at parent company level, which sets reduction targets for all its subsidiaries. It **is neither appropriate nor realistic** to expect a subsidiary to adopt its own plan independently of its parent company and corporate group. Investors look at consolidated data. CO_2 emissions do not stop at borders and counting them does not make much sense at entity level. Once again, this approach is not consistent with the CSRD proposal. Therefore, the proposal should be amended in order to take into consideration the notion of group as mentioned above and allow for exemptions at subsidiaries level when the obligation is performed by the parent company.

Take into consideration interactions between companies subject to due diligence obligations

CS3D does not specifically address and clarify the cases of interactions between companies both subjected to due diligence obligations under the Directive (i.e., company and its suppliers falling themselves under the application of the proposal). Therefore, the proposal should **provide for alleviated obligations when both business relationships are in the scope of the directive.**

Focus risk-based due diligence on supply chains instead of on value chains (Recital 18, Article 3 g)

- According to Recital 18 and Article 3 (g), CS3D aims to cover the entire value chain, upstream and downstream. **This is not in line with OECD guidelines for multinational enterprises which do not refer to the value chain.** Instead, the OECD guidelines ask companies to carry out a **risk-based due diligence** which should seek to prevent or mitigate adverse impacts when they occur through the companies' own activities, or when the impact is directly linked to their operations, products or services by a business relationship.[1] Furthermore, OECD guidelines state that "*the term 'business*

[1] OECD Guidelines for Multinational Enterprises 2011, Chapter II, A points 10, 11, 12, 13 and 14

*relationship' includes relationships with business partners, entities in the **supply chain** and any other non-State or State entities directly linked to its business operations, products or services"*[2].

Upstream established direct and indirect business relationships will cover a vast range of entities and activities (design, extraction, manufacture, transport, storage and supply or raw material, products, parts of products). Conducting due diligence on supply chains will represent a major challenge considering the complexity of global supply chains.

In order to keep the scope of CS3D feasible and realistic, **downstream activities, such as the use of a product by clients or consumers, should be explicitly excluded from the scope of the directive**. There are more appropriate and specific legal instruments governing for example the relationship with consumers, such as Directive 2011/83/EU on consumer rights and more generally the safety of products.

CS3D should replace the term 'value chain' by 'supply chain' and align with the risk-based approach of OECD guidelines and the UN Guiding Principles on Business and Human rights. The control of the use of products, which is problematic both practically and legally, should not be in the scope of CS3D. **The directive should focus on risk-based due diligence on supply chains, explicitly excluding downstream activities.**

Address compliance with overlapping codes of conduct

Article 5 states that the due diligence policy shall contain a code of conduct describing rules and principles to be followed by the company's employees and subsidiaries. In addition, article 7 § 2 b) requires compliance with the company's code of conduct to be included in contractual clauses with business partners. However, if several companies are respectively in the supply chain of their partners, they will have to comply to different possibly diverging codes of conduct (e.g., diverging audit modalities). This would require companies to contractually agree and comply with a multitude of codes of conduct which is unfeasible in practice. CSD3 should address this issue in a pragmatic way.

II. The definitions

Provide more clarity regarding the definitions (article 3):

- **Adverse environmental impact (b):** we understand that greenhouse gas emissions are not included in companies' due diligence obligations. Article 29 (d) seems to exclude climate impacts. Nevertheless, the explanatory memorandum refers to it (p.2) and Annex part 1 includes references to the environment. Companies need clarity since climate liability claims against some companies are based inter alia on human rights grounds. **It should be made clear that considerations around climate included in the CS3D proposal are outside the scope of the due diligence obligation.**

[2] OECD Guidelines for Multinational Enterprises 2011, Chapter II, B point14 page 23

- **Adverse human rights impacts (b)** are defined as adverse impacts 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. The reference to the "violation" of international instruments and Conventions risks creating uncertainty on how this "violation" is ascertained and by whom. Indeed, international conventions are addressed to States, and it is not clear how a company may violate international law which is not directly applicable to it. Also, there are several violations not included in the Annex, Part I, section 1 but which may be however related to the human rights instruments listed in the Annex, Part II, section 2 ("catch-all" clause). Further, the list also includes instruments which are both not legally binding (such declarations) and agreements not globally ratified, therefore in both cases it is not clear how a company may violate an obligation which is not even established as such by the State. **Alignment with the definition given by the UNGPs** (An "adverse human rights impact" occurs when an action removes or reduces the ability of an individual to enjoy his or her human rights, The Corporate Responsibility to Respect – An Interpretive Guide) **and the reference to the human rights instruments and standards relevant to business** ("The responsibility of business enterprises to respect human rights refers to internationally recognized human rights – understood, at a minimum, as those expressed in the International Bill of Human Rights and the principles concerning fundamental rights set out in the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, UNGP n.12.") **would ensure more clarity because they would refer to those "core rights" reflected in customary international law.** This would also be clearer for businesses that already implement the UNGPs framework. In addition, the concept of "right holder" should be preferred to the one of "protected person", as more in line with the practice of human rights due diligence in the field and also included in the UN Protect, respect and remedy framework.

- **Business relationship (e) (ii)** is defined as a "*business relationship with a contractor, subcontractor or any other legal entities that performs business operations related to products or services of the company for or on behalf of the company*". **It is not clear whether this definition relates to <u>indirect</u> relationships**. If it is the case, this must be clarified, as companies need to be precisely informed about the scope of their obligations and to understand to which situation the proposal refers when it mentions "indirect relationships".

- **Established business relationship** (f) is defined as business relationship which is, or which is expected to be lasting, in view of its intensity or duration and which does not represent a negligible or merely part of the value chain. While we appreciate recital 20 stating that due **diligence obligations should be limited in the Directive to "established business relationship**", this should be better specified in the articles of the directive and the definition should be clarified. **In fact, this definition refers to subjective criteria without explaining how to appreciate intensity, duration and negligible or ancillary part of the value chain**. Such a definition should be based on objective and quantifiable criteria to avoid legal uncertainty. Moreover, the "established business relationship" should be referred only to business relationship "**which are relevant" in the supply chain**. The criteria of "not negligeable" and "not merely ancillary" is too weak. First, because to be reasonable and proportionate, the Due Diligence obligations shall be conducted only on the most relevant parts of

the supply chain; second, because of the liability linked to the "established business relationship", which would be unrealistically large. Also, in line with the approach of UNGPs and OECD Guidelines when considering the complexity and number of large companies' business relationships, the scope of the operations to be addressed through due diligence should rather take into consideration **a risk-based approach than general concepts such as intensity and duration.**

- **Director (o):** It is necessary to distinguish in the proposal between executive and non-executive directors specifically when it comes to setting variable remuneration in article 15 § 2 which cannot concern in many countries non-executive directors. In addition, it is not clear in articles 25 and 26 who is responsible for what.

III. Climate change provisions

Clarify the requirement to combat climate change in order to harmonise it with the provisions of the CSRD (article 15)

In light of the ever-pressing warnings of climate science, EuropeanIssuers share the objective of strong business engagement in greenhouse gas (GHG) reduction to contribute to the goals of the Paris Agreement and the European Climate Law. Nevertheless, legal requirements must be pragmatic in terms of implementation by companies, otherwise they will generate legal uncertainty and inhibit ambitious action.

Article 15 "Combating climate change" states that "companies shall adopt a plan to ensure that the business model and strategy are compatible with the limiting of global warming to 1.5 °C in line with the Paris Agreement".

In our view, companies would face two major roadblocks in the implementation of such requirement, and authorities would face the same when enforcing this provision:

- Practical roadblock: no regulated or generally recognized standard exist today for aligning a company's strategy on a given temperature goal. Private initiatives such as SBTi, TPI or others are relevant but none of them is authoritative and, as each one proposes its own specific set of choices and assumptions, they may conflict with each other thus creating critical uncertainty on the expected implementation.
- Legal roadblock: the CSRD and the CS3D would create two related 1.5°C requirements, subject to two distinct enforcement regimes with no legal and procedural coordination, which would inevitably conflict and result in a legal stalemate.

Also, the language of the current proposal seems to suggest that companies are required to implement a standard of immediate results ("ensure", "are compatible") regarding a 1.5° C scenario, which would be hard

to be conceived, whereas the States Parties to the Paris Agreement themselves fail to align their objectives with 1.5°C. [3]

For these reasons, EuropeanIssuers strongly suggests reframing the requirement to make it more future-oriented and aligned with the objectives of the European Climate Law and the Paris Agreement (including the crucial role given to sustainable development and poverty eradication).

Therefore Article 15 should be rephrased as followed:

"(…) shall adopt a plan to make the business model and strategy of the company ~~are~~ compatible with the transition to a sustainable economy and with the long-term temperature goal referred to at Article 1, paragraph 2 of Regulation (EU) No. 2021/1119 [the European Climate Law], in the context of sustainable development and efforts to eradicate poverty. […]."

In Article 17(1), the reference to Article 15 should be deleted to avoid subjecting this requirement to the enforcement regime provided for human rights and environmental due diligence (such due diligence is oriented towards local, specific impacts whereas climate considerations address global impacts of the economy). For the same reason, the scope of "Substantiated concerns" (Article 19) should not cover all articles of the Directive but only Articles 4 to 14.

As mentioned above, it is necessary to give companies the option to consolidate the implementation of this requirement on a corporate group (parent company) level. Consistent GHG emission reduction strategies typically require a consolidated group approach which is then deployed across subsidiaries.

IV. Directors' remuneration

Avoid duplication regarding directors' remuneration

Concerning article 15 § 3 on the variable part of the directors' remuneration to be linked to the contribution of the director to the company's business strategy and long-term interests and sustainability, this subject has already been dealt with by the shareholder rights directive (SRD) which provides in article 9 a § 6: " *The remuneration policy shall contribute to the company's business strategy and long-term interests and sustainability and shall explain how it does so.(…) Where a company awards variable remuneration, the remuneration policy shall set clear, comprehensive and varied criteria for the award of the variable remuneration. It shall indicate the financial and non-financial performance criteria, including, where appropriate,* ***criteria relating to corporate social responsibility,*** *and explain how they contribute to the objectives set out in the first subparagraph, and the methods to be applied to determine to which extent the performance criteria have been fulfilled." In addition, it is not clear whether this paragraph refers to executive directors due to the very broad definition.*

If the intention is to go further, it would be more suitable to amend the SRD. Indeed, SRD concerns listed companies which have a responsibility towards the market and would avoid interfering in the governance of

[3] See UK Presidency, "COP26 THE GLASGOW CLIMATE PACT", page 8.

non-EU companies as they are not included in the scope. In addition, as the definition of directors does not distinguish between executive and non-executive directors, we do not see the rational to require that non-executive directors' remuneration be linked to CSR criteria

V. Due diligence obligations

Provide for a prioritisation of adverse impacts (article 6, 7 and 8)

It would be impossible for companies to perform the six obligations laid down in article 4 all over the world concerning their thousands of suppliers or sub-contractors, country by country, project by project or activity by activity. With a view to make the legislation efficient and effective, also in terms of allocation of companies' resources, it must focus on the **most severe adverse impacts**, as per a risk-based approach in line with the UNGPs and OECD Guidelines, taking into account the fact that it is impossible to mitigate every single risk that may occur on supply chains and mitigate them all at the same time. Due diligence is an ongoing process which has to be improved over time, focusing first on the most salient risks. **The requirements should therefore be focused on the typology of salient adverse impacts identified across undertakings' activities,** which would allow interested parties and stakeholders to better understand the due diligence strategy of the undertaking. Article 3 (q) defines 'appropriate measures' - among other criteria - as those which are commensurate with the degree of severity and the likelihood of the adverse impact.

Finally, it is worth noting that the draft European Sustainability Reporting Standards elaborated by EFRAG do not refer to all impacts, but only **to material impacts** on workers in the value chain, on biodiversity and ecosystems. The CSDD directive should adopt the same approach and ensure coherence with the CSRD' delegated acts to be adopted following technical advice from EFRAG.

Therefore, this risk-based approach should be explicitly referred to in article 6, 7 and 8.

Delete unclear and unfeasible provisions to prevent, mitigate and bring to an end adverse human rights and environmental impacts (article 7 § 3 and article 8 § 4):

It is said in article 7 § 3 that "*as regards potential adverse impacts that could not be prevented or adequately mitigated, the company may seek to conclude a contract with a partner with whom it has indirect relationship, with a view to achieving compliance with the company's code of conduct or a prevention action plan*". A similar wording is included in article 8 § 4 as regards actual adverse impacts that could not be brought to an end or adequately mitigated.

The conclusion of contracts with indirect relationships is not part of the usual due diligence measures recommended by UNGP or OECD Guidelines and numerous legal and practical questions arise such as: What would be the terms of the contract? **How can a company which has concluded a contract with its direct relationship may conclude at the same time a contract with its indirect relationship**? What would be the financial or other compensation of such an agreement? In addition, as the relationship would transform into

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a direct business relationship, liability rules would be even stricter which means that there would be a legal risk to follow this provision.

This provision should be brought in line with OCDE due diligence guidance and clarified according to recital 29 of the draft proposal which states that it should be taken into consideration the companies' influence over a business relationship, meaning its ability to persuade the business relationship, and the degree of influence or leverage that the company could reasonably exercise. Moreover, it is even more important to take this into consideration with reference to 7§4 and 8§5 (appropriate measures to verify compliance with contractual assurance and contract). This being said, we do believe that the inclusion of contractual assurances in contracts with a counterparty should be taken into account as a mitigating factor in terms of liability of the company, in cases where the counterparty is responsible for or contributes to an adverse impact on human rights.

Also, **article 7 § 3 to 6 overlap with article 8 § 4 to 7 which creates confusion**. Regarding "potential adverse impacts that could not be prevented," it would be more logical to refer to article 8 which addresses the issue of mitigating. Consequently, article 7 § 3 to 6 could be deleted and replaced by the sentence "As regards potential adverse impacts that could not be prevented by measures in § 2, article 8 shall apply".

Finally, article 7 § 4 states that where measures to verify compliance are carried out in relation to SMEs, **the company shall bear the cost of independent third-party verification**. The question of who should bear the cost of independent third-party verification in relation to SMEs should be further discussed. **Experience shows that SMEs who contribute financially to their third-party verification** – even with a very small amount - **are more motivated to participate**. **A shared cost model has the advantage to improve supplier engagement because they also "own" the result of the verification and can use it with other buyers.** This allows them to see verification as a part of their own sustainability strategy and not as a mere compliance exercise. EuropeanIssuers' members believe that there needs to be flexibility for buyers to decide, together with SMEs, which cost model is best suited to improve due diligence on their supply chains. The coverage may also be much larger in the case of a shared cost model because more SMEs can be included in the scheme.

Address ESG ratings role in the implementation of the due diligence

As reflected in recent consultations carried out by ESMA and the European Commission, ESG ratings have become more and more relevant and companies, especially in the financial sector, are increasingly relying on ESG providers in order to develop internal ESG scores on clients and counterparties. Against this backdrop, it would be desirable to obtain a clarification on the role that ESG ratings may have on supply chain's due diligence process required by the CS3D Proposal. **Especially, it could be clarified if and to what extent companies may rely on ESG ratings attesting a good ESG performance of their established business relationships as part of their due diligence.**

Clarify the implementation of the Directive in the financial sector

The exclusion of small and medium-sized enterprises from the supply chain related to financial sector is consistent with the difficult balance between feasibility and benefits that the Directive aims to achieve, and it is important that it is preserved during the legislative process.

However, the current wording appears to limit the exclusion only to SMEs "receiving loan, credit, financing, insurance or reinsurance", not considering the breadth of financial services that are provided to SMEs (e.g., payments services). A new wording introducing a general exclusion of SMEs from the value chain of regulated financial is needed.

Moreover, in view of the objectives of the Directive, the due diligence obligation for financial undertakings should be supposed to concern only the phase of onboarding of new clients, and not already established relationships (e.g., the opening of further contracts or the provisions of financial services following the first). Clarification in this respect is essential.

Provide for alleviated due diligence obligations for companies whose activities and direct business relationship are all domiciled within the European Union

Companies whose activities and direct business relationship are exclusively domiciled within the European Union should be subject to alleviated due diligence obligations as the risks of human rights and environmental adverse impacts are less likely to occur due to the fact that European countries already guarantee a high level of human rights and environmental standards[4].

Clarify the due diligence obligations regarding non-EU companies (article 2):

EuropeanIssuers supports the extension of the scope of the proposal to non-EU companies in order to create a level playing field for EU businesses. The proposal states that for determining whether non-EU companies fall under the scope of this directive, **the turnover must be generated within the EU**. If the purpose is to create a fair level playing field, then why European companies have to generate a net worldwide turnover of EUR 150 million, while third countries companies have to generate the same threshold, but only in the EU? It could have been expected that companies of group 2 would have to meet a lower threshold as it is only calculated at EU level. In addition, it is **not clear whether their due diligence obligation concerns all operations of the non-EU entity worldwide or only those linked to the products or services offered in the EU**.

For example, a US subsidiary of a European company which sells goods in the EU, does it have to report on due diligence regarding its whole operations with the rest of the world or only on the supply chain for goods and services exported to the EU? Indeed, as the proposal stands, the non-EU entity would have to apply articles 7 and 8 without any limitations regarding the scope of the due diligence obligations.

[4] See Article 4 of the "European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability" (2020/2129(INL)).

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Even if the objective of the measure is to give it an extraterritorial scope, it is necessary to have at least a territorial connection with the products or services offered. Business relationships, whether direct or indirect, which do not affect the European market, should not be included in the scope of the Directive.

Therefore, it **should be clarified that for non-EU entities due diligence obligations are limited to the supply chain of the products offered in the EU.**

Adopt a more nuanced approach on suspending or terminating commercial relationships (article 7 § 5 and article 8 § 6)

The proposal states that "*in order to ensure that bringing actual adverse impacts to an end or minimising them is effective, companies should prioritize engagement with business relationships in the value chain, instead of terminating the business relationship, as a last resort action after attempting at bringing actual adverse impacts to an end or minimising them without success*[5]".

The suspension or termination of business commercial relationships is seen **as a last resort obligation** after the company has attempted to take all necessary preventive measures. As such, this last resort measure may be appropriate under certain circumstances, described by OCDE Guidelines, when **adverse impacts are irremediable**; where there is **no reasonable prospect of change**; or when **severe adverse impacts or risks are identified** and the entity causing the impact does not take immediate action to prevent or mitigate them.

However, OECD Guidelines also underline that **in some instances it may not be possible or practicable to end a business relationship**, for example where the supplier is a crucial relationship supplying a core product like rare earth minerals which are only available from very few suppliers.

Also, it should be considered that further, even severer impacts could result as a **consequence of disengagement as mentioned by the OECD Guidelines**[6] **which invite companies to "*take into account potential social and economic adverse impacts related to the decision to disengage*"**. Therefore, the decision to disengage is extremely difficult to take, often involving **ethical considerations** (e.g., a company which provides medical supply or infant milk). It raises also an important **political question** whether the EU wants its companies to leave all high-risks area and leave operations there to less regarding competitors who are likely to make things much worse for the local population or the environment. Unless clearly dictated by law, this decision will have to be taken by the company after careful balancing of all options.

At the same time, leaving termination as a last resort does not consider situations where the company may need to terminate because the business relationship exposes it to commercial and/or legal risks from a human rights perspective.

EuropeanIssuers considers that there are several changes necessary to bring in a more nuanced approach:

[5] Recital 41
[6] OECD Guidelines §22

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- **Disengagement cannot be a legal obligation**, because every company has to take this decision in the light of its specific situation, after carefully considering ethical issues and balancing risks linked to terminating the business relationship or not. Such decisions should be left up to the discretion of companies, to be evaluated on a case-by-case basis, also taking into consideration the effect of supply chain's disruptions on the whole EU economy.

- **The provision on disengagement should also take into account the responsibility of States. States could indeed provide for additional/complementary instruments and bring more clarity as regards the appropriate responses that have to be taken in specific cases. In this regard, some States** have already banned the entry into their territory of products manufactured in specific areas, e.g., the US who prohibit the importation of goods made with forced labour[7]. The proposal should also clarify that in such cases, checking whether, in the concerned supply chain, the goods or products are mined, produced, or manufactured in banned areas could be considered as part of the due diligence obligation implementation. In addition, the proposal should offer technical and other appropriate support to comply with this rule, as it might be difficult for companies to identify the existence of forced labour.

- Where companies consider, under article 7 or 8, terminating their relationship with the partner with which the adverse impact is anticipated or has arisen, due reference should be made, like in the OECD guidelines, to the fact that they should also take into account potential social and economic adverse impacts related to the decision to disengage

- **The possibility of disengagement should be maintained only in article 8 on ending actual adverse impacts. It should be deleted from article 7 on potential adverse impact prevention** in order to avoid confusion between article 7 and 8. The potential impacts addressed by article 7 are not an appropriate basis for this disengagement as a last resort. In article 7 on potential impact prevention, it is sufficient to require companies to refrain from entering into new or extending existing relations.

Provide protection under competition law regarding exchanges of sustainability related information between competitors (article 4 §2)

Article 4 §2 states that "*companies are entitled to share resources and information within their respective groups of companies and with other legal entities in compliance with applicable competition law*". However as progress in relation to sustainability will most likely require businesses to collaborate and exchange of sustainability-related information, clarity is needed regarding the types of resources and information that can be shared without being considered as an anti-competitive conduct falling under article 101 (1) °TFEU. The Commission is revising its guidelines on this issue [8]. § 9.2 give examples of agreements which are not

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7 US Public Law 117-78 dec.23, 2021 (Act to ensure that goods made with forced labour in the Xinjiang Uyghur Autonomous Region of the People's Republic of China do not enter the United States market). See also the EU's envisaged ban on goods made using forced labour, announced for September 2022..

8 Draft communication from the Commission, Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements

raising competition concerns. However, these examples are illustrative and not exhaustive and there remain many grey areas. By contrast, companies need clarity on the conditions allowing to benefit from a safe harbour.

Address the responsibility of States when making international conventions applicable to companies (article 3 b) and c) and the Annex to the directive proposal)

Art. 3 b) and c) define an 'adverse environmental impact' as an adverse impact resulting from the violation of one of the prohibitions and obligations pursuant to the **international environmental conventions** listed in the **Annex, Part II**; and an 'adverse human rights **impact' as adverse impact on protected persons resulting from the violation of one of the international conventions** listed in the Annex, Part I Section 2. As mentioned also above in "II. definitions", the structure of the Annex does not ensure clarity and a reference to the "international recognized human rights" as stated in the UNGPs should be preferred.

International conventions are agreements between different countries which are legally binding only to the contracting States, and only when that State ratifies it. By contrast, **the directive proposal will make the relevant conventions directly applicable to companies** within its scope without addressing the numerous question this raises in practical and legal terms. **Indeed, companies cannot "violate" international conventions they are not directly a party to**, therefore the Directive should use wording such as that included in the UNGPs, such as "failure to respect" or "avoid causing/contributing to adverse impacts on human rights". The references instruments should be those included in the UNGPs such as the International Bill of Rights (ICCPR and ICESCR) and the ILO Tripartite Declaration.

While companies can make their best efforts to mitigate risks also in countries which have not signed or ratified certain international conventions, there may be **inextricable situations when the country has adopted legislation which is contrary to the convention**, for example by strictly prohibiting the freedom of association.

OECD guidelines explicitly state that "*obeying domestic laws is the first obligation of enterprises. (…). In countries where domestic laws and regulations conflict with the principles and standards of the guidelines, enterprises should seek way to honour such principles and standards to the fullest extent which does not place them in violation of domestic law*"[9]This principle must be introduced in the directive proposal.

Similarly, protective legislation may exist in theory, but the government, administration or state-owned companies may be involved in human rights abuses or causing harm to the environment. In these cases, it should be clarified what is appropriate to require the EU company to do. Also, it should be underlined that **terminating the business relationship will in many, if not most cases, not bring about positive change** in the host country as non-EU competitors with different or lower human rights standards will take the place of EU companies.

[9] OECD Guidelines for Multinational Enterprises 2011, Chapter I, point 2, p. 17

OECD and UN guidelines explicitly recognise that **companies cannot replace failing and weakly governed states in which protective laws are either inexistent or not applied**. EU companies alone will not be able to change such situations in their host countries but will rely on multi-stakeholder initiatives including other States or international organisations to improve the situation. **The directive proposal should address this situation to avoid that EU companies would have to massively exit certain countries** which could have serious repercussions on EU supply chains and industries' capacity to pursue their activity, not to mention the decrease of European Union political influence in certain areas

Design a monitoring process which does not create undue burden on companies (article 10)

Article 10 states that companies should "carry out periodic assessments 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" to monitor the effectiveness of their due diligence measures at least every 12 months and whenever there are reasonable grounds to believe that significant new risks of the occurrence of those adverse impacts may arise. **This frequency and scope are totally unrealistic and unfeasible**. The due diligence exercise is a highly complex process, involving the assessment of up to thousands direct suppliers. The risk identification alone takes on average 18 months for large companies. Once performed, certain risks may be considered permanent, others not.

Art. 10 should be reformulated to limit the yearly periodic assessment to the monitoring of appropriate qualitative and quantitative indicators. The assessment of all operations (own, subsidiaries, value chain) is impossible to perform very year. The periodicity may not be less than 3 years unless a significant risk has been identified which justifies updating the due diligence policy without any delay.

VI. Complaints procedures

Provide consistency with other EU whistle-blowers laws and better circumscribe the persons who can submit complaints (article 9 § 2 c) or substantiated concerns (article 19 § 1)

The proposal should clearly address the relationship between article 9 and other legislations such the **directive on the protection of persons who report breaches of Union law**.

In addition, the proposal states that complaints may be submitted also by "civil society organisations active in the areas related to the value chain concerned" (article 9 c).

Companies do not contest the important and constructive contributions of many NGOs in general, but regret that there are currently **no transparency requirements obliging these organisations to disclose how they are funded, or which interests they represent**. The broad formulation of article 9 § 2 c opens the door to abuses contrary to the aim of this directive and could result in an excessive number of complaints procedures. Indeed, some NGOs act in an opaque manner on behalf of States or particular financial interests and could easily exploit this procedure with a view to destabilise a company (or competitor hidden behind the persons funding the NGO). Member States should therefore be able to make the admissibility of such complaints

subject to a minimum of transparency or to the fact that the organisations filing a complaint are associations recognised as being of public utility.

In article 19 § 1, it is not clear why natural and legal persons can submit **substantiated concerns** to the supervisory authorities while, when it comes to companies, persons and organisations can submit **legitimate concerns.** Indeed, the **concerns addressed in article 9 should not only be legitimate but also substantiated** in order to avoid a flow of insignificant or anecdotal complaints and the person who report should have "reasonable grounds to believe that this information reported was true at the time of reporting"[10].

At last, it would be important to explicitly **provide for group solutions as subsidiaries may have limited resources in terms of employees and means to meet their obligation under the directive**. Indeed, it is not clear whether article 4 § 2 is applicable to complaints procedures. Therefore, subsidiaries should be allowed to share resources as regards the receipt of reports and the carrying out of investigations with the parent company. The compliance officer of the subsidiary, if any, may not have the expertise to deal with complex matters alone and it is important that the parent company be aware of concerns which may have a reputational impact on the whole group.

VI. Civil liability regime

Clarify the civil liability regime (article 22)

As it stands, article 22 would lead to **disproportionate litigation risks for companies** as the proposal contains many unclear legal terms and is very broad in its scope of application.

The § 1 of the proposal states that the company should be liable for damages if it failed to comply with the obligations mentioned in article 7 and 8 to prevent and mitigate potential adverse impacts or to bring actual impacts to an end and minimise their extent, and as a result of this failure an adverse impact that should have been identified through the appropriate measures occurred and led to damages.

It should be clarified that this regime does not derogate from the ordinary rules on the burden of proof in liability claims. Indeed, the **plaintiffs should have to prove a failure to comply with the obligations, a damage and a clear link between the failure and the damage**.

Further, the a) is too broad as it refers to article 7 and 8. It should be amended in order to clarify that **companies may be liable when they have not taken "appropriate measures"** as defined in article 3 q) and recital 15 which acknowledge that companies cannot "*guarantee, in all circumstances, that adverse impacts will never occur or that they will be stopped* and, therefore, that the main obligations of this Directive should be "obligations of means", taking into account the specificities of its supply chain, sector or geographical area, its power to influence, and the possibility to increase its leverage.

[10] DIRECTIVE (EU) 2019/1937 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 October 2019 on the protection of persons who report breaches of Union law (article 6 § 1 a)).

The § 2 states that as regards damages occurring at the level of indirect business relationships, the company should not be liable if it carried out specific due diligence measures. However, the proposal also indicates that the company should not be exonerated from liability if ***"it was unreasonable, in the circumstances of the case, to expect that the action actually taken, including as regards verifying compliance, would be adequate to prevent, mitigate, bring to an end or minimise the extent of the adverse impact*".** The sentence "unless it was unreasonable…" (§ 2) lacks clarity and is too vague and subjective to be the basis of a responsibility regime. Which criteria would allow to judge that the measures taken are inadequate to prevent or mitigate the risk? In the presence of damage, the judge will be led to consider that the measures were *de facto* inadequate. Therefore, the burden of proof should be reversed, and it should be clarified at least that this is up to the plaintiff to prove that the due diligence measures were manifestly insufficient, in the circumstances of the case, to tackle the issue.

Therefore, this paragraph should be amended as followed: (…) *"unless it is proven by the plaintiff that the actions actually taken were, in the circumstances of the case, clearly inadequate to prevent, mitigate, bring to an end or minimise the extent of the adverse impact".*

Furthermore, § 3 should clarify that in any event the duplication of liability for the same damage has to be excluded and that a cumulation of remedies has to be discouraged in the interest of legal certainty and the rule of law.

Delete the provision that gives overriding mandatory application to national law (article 22 §5)

In order to ensure that victims can bring an action for damages and claim compensation for damages arising due to a company's failure to comply with its due diligence obligations, even when the law applicable to such claims is not the law of a member state, the directive requires member states to ensure that the liability provided for in provisions of national law transposing this article is of overriding mandatory application in cases where the law applicable to claims to that effect is not the law of a member state.

We believe that this provision is problematic as it is possible that the laws of third States provide for standards which are higher than those applicable at the level of the Member States.

Clarify directors' duty of care and the setting up and overseeing of due diligence (article 25 and 26)

- Directors' duty of care

Article 25 refers to the concept of duty of care, which is well known in the Anglo-Saxon world, but less widespread in Europe. Moreover, when it exists, it usually refers to the duty of managers towards the company and not towards third parties.

When comparing this provision with the provisions introduced by the French Pacte law on the consideration of social and environmental issues, one should note that **the aim of article 1833 of the French civil code is**

to anchor CSR in the management of the company and not to create a new cause of corporate liability. Similar provisions are already observable in a number of national jurisdictions:

- The **Italian Corporate Governance Code** has a general and overarching principle recommending the board to "*pursue the sustainable success of the company's activity" and defines it as "the objective that guides the actions of the board of directors and that consists of creating long-term value for the benefit of the shareholders, taking into account the interests of other stakeholders relevant to the company*". To this end it promotes the board's "dialogue with shareholders and other stakeholders which are relevant for the company" to be developed "in the most appropriate way".
- The **Belgian 2020 Corporate Governance Code** recommends that the board "*pursue[s]sustainable value creation by the company, by setting the company's strategy, putting in place effective, responsible, and ethical leadership and monitoring the company's performance".*
- The **German Corporate Governance Code** contains recommendations that intent to ensure that the management board and supervisory board assume "*managing the company in the best interests of the company, meaning that it considers the needs of the shareholders, the employees and other stakeholders, with the objective of sustainable value creation*".
- The **Dutch Corporate Governance Code** recommends that the management board focusses "*on long-term value creation for the company and its affiliated enterprise and takes into account the stakeholder interests that are relevant in this context".*

As this subject is **already embedded in national law or national corporate governance codes,** EuropeanIssuers shares the Regulatory Scrutiny Board concerns and does not see either "*why existing sustainability strategies and corporate management practices are considered as insufficient or what in practice companies would have to do to have adequate sustainability governance practices in place*".

Conversely, Article 25 § 2 seems to establish the **liability of directors in the event of breach of the directors' duties.** However, the added value of EU action in this respect has yet to be demonstrated since all Members States have in place a liability regime that apply both for companies and directors.

- Overseeing of due diligence

The wording of article 26 is unclear and needs to be amended. The word "responsibility" has to be understood as an attribution of roles for putting in place and overseeing the due diligence actions. However, it should be made clear that putting in place the due diligence actions according to article 4 should be assigned to corporate bodies and not to directors. Indeed, it should be up to Members States to decide who among executive and non-executive directors is responsible for putting in place and overseeing the due diligence policy.

In addition, article 26 § 1 introduces an additional consultation of stakeholders and civil society organisations at the level of directors which is not appropriate as the way communication with third parties is conducted depends on each company and can be organised in very different ways, usually not at board or executive directors' level.

Therefore, article 26 should be amended as follows:

"Members States shall ensure that administrative, management or supervisory bodies of companies referred to in Article 2 (1) are, where applicable, responsible for putting in place and overseeing the due diligence policy referred to in Article 5. Where applicable, the board of directors or the supervisory board is informed in that respect.

Members States shall ensure that administrative and management bodies take steps to adapt the corporate strategy to take into account the actual and potential adverse impacts identified pursuant to article 6 and any measures taken pursuant to Article 7 to 9".

VII. Supervisory authorities

Provide for a well-balanced supervisory system including non-judicial remediation mechanisms

The role of the **supervisory authorities should be revised**. From a practical point of view, it is difficult to see how a national authority, even the most staffed one, may supervise, in an effective way, all companies subject to the due diligence requirements, request information and carry out investigations.

As regards the role of the supervisory authority, they should:

- **act as "help desks" rather than quasi-courts.** Their role could therefore be designed to **assist undertakings in their risk analysis by sharing tools and intelligence,** for example on high-risk geographical zones and to implement their due diligence strategy.

- **integrate the mediation role played by OECD National Contact Points (NCP) as they offer a unique State-based non-judicial mechanism through which the non-respect of due diligence can be effectively raised**. Almost 50 NCPs currently exist for each government adhering to the OECD Guiding Principles. The NCPs offer a non-judicial grievance mechanism which help to resolve issues that can arise if the OECD due diligence guidelines are not observed. **NCPs are often more efficient than lengthy judicial procedures**. They contribute to improving access to remedy for victims of business-related rights violations, especially in cross-border transactions where judicial systems may fail. The above would imply that the powers of the supervisory authority and the NCPs are coordinated so as to avoid overlaps and excessive burdens for corporates.

- **liaise with embassies and diplomatic networks** in third countries who could work closely together with companies and facilitate cooperation with key actors in the third country (administrations, authorities, independent agencies, associations, international organizations, NGOs, etc.). Only such multi-stakeholder cooperation will be able to meet the challenges of overly complex issues such as forced labour or child labour, challenges which are impossible to be solved by a single company. In order to fulfil this role, embassies should train at least some of their staff on the environmental and

human rights risks likely to exist in the countries of their assignment. This staff could then proactively lead a network for the exchange of best practices and support for EU companies operating in the country in question.

If the investigative and sanctioning powers of the supervisory authorities were to be maintained, **companies should not be exposed at the same time to investigations with potentially administrative sanctions and judicial proceedings on the same grounds.** The proposal should indicate clearly that the "*non bis in idem*" principle applies to avoid that a company is sanctioned twice for the same facts under administrative and judicial proceedings.

In the case of a group of companies, where the resources are shared within the group, there should be one single authority to avoid multiple supervisions.

VIII. Sanctions

Sanctions should be progressive, appropriate, and proportionate to the severity of the breach (articles 18, 20, 24):

The proposal provides for multiple sanctions which may hit the company simultaneously or in a cumulative manner which seems disproportionate. Indeed, the following consequences in case of ineffective or failing due diligence can be identified:

- Payment of damages to the affected persons (article 8 § 3 a)
- Payment of financial compensation to the affected communities (article 8 § 3 a)
- Remedial action ordered by the supervisory authority (article 18 § 5 a)
- Payment of pecuniary sanctions in accordance with article 20 (article 18 § 5 b)
- Adoption of interim measures to avoid the risk of severe and irreparable harm, ordered by the supervisory authority (article 18 § 5 c)
- Ban from "public support" in case of sanctions (article 24)
- Civil liability for damages (article 22).

A **progressive, step by step approach** should be provided for as regards these different consequences and sanctions. It would be disproportionate to expose a company at the same time to all of these measures.

As regards article 20, EuropeanIssuers would have expected a certain level of harmonisation concerning sanctions. As supervisory authorities will have to collaborate, it seems curious that similar infringements may be subject to administrative sanctions in one country and not in others.

In addition, article 24 states that "*Member States shall ensure that companies applying for public support certify that no sanctions have been imposed on them for a failure to comply with the obligations of this directive*". There is **no definition of public support.** It does not make sense that article 24 amounts to creating a systematic ancillary sanction, barring access to any type of public support, with no time limit and no

conditions in particular in terms of severity of the breach. It should be left up to Member States to decide whether and to which extend they wish to adopt such sanctions as stated in article 20 § 1.

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