

OPINION ARTICLE

THE EU DIRECTIVE ON CORPORATE SUSTAINABILITY DUE DILIGENCE: SUCCESS OR A FAILURE?

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Abstract

Formally endorsed by the European Parliament and the Council of the European Union in spring 2024, the Directive on Corporate Sustainability Due Diligence is going to become an EU legally binding instrument. The present article comments on the main features of this legislation and highlights that despite its strong initial ambitions, the final text of the Directive has considerable weaknesses, such as rather limited scope, exclusion of the financial sector for downstream operations, as well as vague and rather weak provisions that may lead to the possibility to escape liability. As this opinion piece will argue, there are serious doubts on whether the Directive will indeed achieve its goal of fostering respect for human rights and environmental protection among the companies' operations and across their global value chains.

Keywords: EU Directive, CSDDD, Corporate Social Responsibility, Value Chain

I. Introduction

In the past several years, companies started to give more consideration to corporate sustainability by disclosing information about the social and environmental impact of their business operations as, among other things, they understood the importance of investing in sustainability to unlock greater access to capital, markets and talent.¹ Until recently, however, there was no EU-wide legislation in this respect, even though due diligence laws started to emerge on national levels in countries such as France and Germany while some Member States like the Netherlands, Belgium, Luxembourg and Sweden were planning to introduce similar laws.² Considering these developments, it became important to harmonise the requirements for companies to carry out due diligence obligations to ensure a level playing field in the single market.

In April 2020, Commissioner for Justice Didier Reynders announced the plan to introduce the legislation and only on 23 February 2022, the European Commission adopted the proposal for a Directive on Corporate Sustainability Due Diligence (CSDDD).³ According to the explanatory

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¹ K Bakhtina, and J W Goudriaan 'CSR reporting in multinational energy companies' (2011) 17 Transfer: European Review of Labour and Research, 95; Focus, '4 Reasons ESG and sustainability are moving up the corporate agenda' < <https://focus.kornferry.com/4-reasons-esg-and-sustainability-are-moving-up-the-corporate-agenda/> > accessed 11 June 2024.

² Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, COM/2022/71 final (Commission proposal).

³ RBC, 'European Commission promises mandatory due diligence legislation in 2021' < <https://responsiblebusinessconduct.eu/wp/2020/04/30/european-commission-promises-mandatory-due-diligence-legislation-in-2021/> > accessed 18 June 2024.

memorandum, the goal of the Directive is to introduce corporate due diligence obligations applying to EU companies based on turnover criterium and size and non-EU based companies considering the turnover generated in the European Union.⁴ The initial Commission proposal stipulated a rather wide scope and aimed at fostering corporate responsibility for human rights and environmental protection within the companies' operations and across their global value chains. Specifically, the initial Directive would have required companies to perform due diligence through their entire value chain, including upstream and downstream activities. It would have also applied to the financial sector and it specified lower employee and turnover thresholds for high-impact sectors, subjecting them to the Directive's obligations if these thresholds were met.

After months of lengthy negotiations and compromises which considerably reduced the scope of the law as well as introduced other changes, the Permanent Representative Committee of the Council of the European Union endorsed the draft Directive on 15 March 2024 and the Parliament voted in favour on 24 April 2024.⁵

The goal of the present article is to highlight the main aspects of the recently adopted CSDDD and to argue that despite strong ambitions initially foreseen in the proposal, the final text of the Directive has considerable weaknesses, such as its limited scope, inclusion of the financial sector only for upstream operations, and rather vague and weak provisions that may lead to the possibility to escape liability.

II. Reactions of the Stakeholders

Various key stakeholders, including representatives of EU institutions, trade unions, companies and European NGOs, reacted to the adoption of the law by presenting diverse perspectives. According to the European Parliament rapporteur Lara Wolters, the 'law will have major consequences throughout the world and will prevent companies from looking away from human misery and destruction'.⁶ Despite underlining the fact that the adopted law is not very ambitious, ETUC, the European Trade Union Confederation, stated that the Directive would lead to considerable improvement when it comes to respect for the human rights of millions of workers in the supply chains of businesses operating in the EU. Similarly, the NGOs Friends of the Earth Europe and Share Action mostly welcomed the Directive, but also expressed their disappointment over the fact that the final text was considerably weakened⁷ and that they would have preferred more far-reaching legislation.⁸

⁴ Article 6 of the Commission proposal establishes the obligation for Member States 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. According to Article 2 of the Commission proposal, as a general rule, EU companies with more than 500 employees on average and a worldwide net turnover exceeding EUR 150 million in the financial year preceding the last financial year should be required to comply with due diligence obligations. The Directive would apply to companies which are formed in accordance with the legislation of a third country if they generated a net turnover of more than EUR 150 million in the Union in the financial year preceding the last financial year. Lower thresholds were established for companies operating in high-impact sectors, such as agriculture, forestry, fisheries.

⁵ European Parliament, 'Due diligence: MEPs adopt rules for firms on human rights and environment' <<https://www.europarl.europa.eu/news/en/press-room/20240419IPR20585/due-diligence-meps-adopt-rules-for-firms-on-human-rights-and-environment>> accessed 6 May 2024.

⁶ Agence Europe, 'EU Member States approve Due Diligence Directive, but considerably reduce its scope' <<https://agenceurope.eu/en/bulletin/article/13372/9>> accessed 18 May 2024.

⁷ Friends of the Earth Europe, 'EU Parliament vote on Due Diligence law: important but insufficient step to put human lives above business profits' <<https://friendsoftheearth.eu/press-release/eu-parliament-vote-on-due-diligence-law-important-but-insufficient-step-to-put-human-lives-above-business-profits/>> accessed 18 May 2024.

⁸ Share Action, 'European Parliament greenlights the CSDDD: historic moment for corporate accountability in the EU' <<https://shareaction.org/news/european-parliament-greenlights-the-csddd-historic-moment-for-corporate-accountability-in-the-eu>> accessed 18 May 2024.

The business representatives, on the other hand, voiced concern about the impact of the Directive on businesses. Eurometaux, an association that represents the European non-ferrous metals industry stressed the necessity to ensure consistent application across Member States, despite acknowledging the significance of the adopted Directive.⁹ Vladimír Dlouhý, the President of Eurochambres, expressed concerns that the Directive will damage global competitiveness and be a threat to the level playing field.¹⁰

Similarly, BusinessEurope, a cross-industry European social partner commenting on the CSDDD, highlighted the importance of ensuring harmonised transposition and clear guidance for companies.¹¹ While according to some commentators¹² the adoption of the CSDDD would prevent legal fragmentation, there are doubts in this respect since the final text foresees the harmonisation of only three articles¹³ and the Directive gives considerable leeway when it comes to the transposition.¹⁴ Therefore, there is a high possibility that the transposition of the Directive will lead to the introduction of divergent national provisions by Member States, which will result in legal fragmentation that subsequently can indeed hamper global competitiveness.

III. Subject Matter

According to Article 1, the Directive sets the rules on ‘obligations for companies regarding actual and potential human rights adverse impacts and environmental adverse impacts, with respect to their own operations, the operations of their subsidiaries, and the operations carried out by their business partners in companies’ chains of activities of those companies’. In principle, the companies will be obliged to show that they have undertaken all appropriate measures to effectively identify risks and prevent, terminate, mitigate, address or remediate actual and potential adverse impacts. The Directive also determines liability for violations of these obligations. It prescribes civil liability for non-compliance with the obligations to prevent potential adverse impacts and to bring actual adverse impacts to an end and establishes sanctions.¹⁵

Moreover, the Directive includes an obligation ‘to adopt and put into effect a transition plan for climate change mitigation which aims to ensure, through best efforts, compatibility of the business model and strategy of the company with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C’.¹⁶ However, there are no enforcement measures such as penalties foreseen in case a company does not comply with this provision, making it more a recommendation rather than an obligation.

⁹ Eurometaux, *EU Due Diligence and Forced Labour Laws: European Parliament confirms balanced path forward* (Press Release April 2024).

¹⁰ Eurochambres, ‘European Parliament vote on Corporate Sustainability Due Diligence undermines supply chains and competitiveness’ <<https://www.eurochambres.eu/publication/european-parliament-vote-on-corporate-sustainability-due-diligence-undermines-supply-chains-and-competitiveness/>> accessed 8 May 2024.

¹¹ BusinessEurope, *EU Corporate Sustainability Due Diligence Directive: BusinessEurope reacts to the Council adoption* (Press release May 2024).

¹² J.Janssen, ‘The Corporate Sustainability Due Diligence Directive would ensure a level playing field and enhance necessary corporate sustainability’ <<https://europeanlawblog.eu/2024/03/12/the-corporate-sustainability-due-diligence-directive-would-ensure-a-level-playing-field-and-enhance-necessary-corporate-sustainability/#:~:text=The%20Directive%20aims%20to%20promote,field%20and%20improve%20corporate%20sustainability.>> accessed 20 May 2024.

¹³ Article 4 says that ‘Without prejudice to Article 1(2) and (3), Member States shall not introduce, in their national law, provisions within the field covered by this Directive laying down human rights and environmental due diligence obligations diverging from those laid down in Article 8(1) and (2), Article 10(1) and Article 11(1).’

¹⁴ The Danish Institute for Human Rights, *The EU Corporate Sustainability Due Diligence Directive. Maximizing impact through transposition and implementation* (The Danish Institute for Human Rights 2024).

¹⁵ See section VI for more details.

¹⁶ European Parliament legislative resolution of 24 April 2024 on the proposal for a directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 (COM(2022)0071 – C9-0050/2022 – 2022/0051(COD)).

Under the Directive, companies are required to fulfil their due diligence obligations throughout their “chain of activities”, a term that has replaced the previously broader concept of the “value chain”. According to the final text, “chain of activities” refers to the activities of a company’s upstream business partners related to the production of goods or the provision of services by the company, including the design, extraction, sourcing, manufacture, transport, storage and supply of raw materials, products or parts of the products and development of the product or the service. That means that in principle, a large company that sells coffee would have to follow its product starting from the extraction of raw materials up to the finished product. “Chain of activities” also refers to activities of downstream business partners engaged in the distribution, transport and storage of the product for the company or on behalf of the company. Not included, for example, is the disposal or recycling of the product, which makes the adopted text less comprehensive than the initial proposal covering the full value chain.¹⁷

IV. Scope of the Directive

As a general rule, the Directive targets companies with more than 1,000 employees and a net worldwide turnover of more than 450 million EUR. The Directive also applies to companies that do not meet these thresholds individually but are the ultimate parent companies of groups that met these thresholds in the most recent financial year for which consolidated annual financial statements have been, or should have been, adopted. Additionally, the Directive applies to companies with franchising or licensing agreements in the EU that ensure a common corporate identity and have a net worldwide turnover exceeding 80 million EUR, provided that at least 22.5 million EUR is generated by royalties. Non-EU companies, parent companies and companies with franchising or licensing agreements in the EU that reach the same turnover thresholds in the EU will also be covered.¹⁸ Generally, companies outside the EU must comply with the Directive if they generate more than 450 million EUR in net worldwide turnover within the European Union.

Based on the preliminary data presented by the Centre for Research on Multinational Corporations (SOMO), 5,421 companies will now fall under the current scope of the Directive. This represents a 67% reduction from the 16,389 companies covered under the initial agreement between the European Parliament and the Council in December in 2023.¹⁹ Indeed, the scope of the Directive has been significantly narrowed compared to the initial proposal of the European Commission, which stipulated that for EU companies, the Directive would apply if a company has more than 500 employees on average and a net worldwide turnover of more than 150 million EUR.²⁰ Moreover, the previous suggestion of the Commission to set lower thresholds for high-risk sectors, such as the manufacture of textiles, forestry and agriculture, has been removed from the proposal.

In addition, regulated financial undertakings will have to comply with due diligence obligations only for the upstream part of their chains of activities.²¹ This means that customer-related activities, such as lending, are not required to be considered for due diligence obligations. This may be a considerable limitation, given the high risk the financial sector poses to human rights and the environment.²² Financial instruments such as credits and investments may be used to facilitate human rights violations. Even though existing regulatory frameworks require financial institutions to address human rights and environmental issues, Cerrahoglu argues that the financial sector should be covered by CSDDD, as it mandates a proactive due diligence process that strives to prevent or mitigate

¹⁷ Amnesty International, ‘Appeal for ambitious EU corporate accountability law’ <<https://www.amnesty.eu/news/appeal-for-ambitious-eu-corporate-accountability-law/>> accessed 17 May 2024.

¹⁸ Article 2.

¹⁹ The European Parliament and the Council of the EU reached a provisional agreement on the corporate sustainability due diligence directive on 13 December 2023. However, the Belgian Presidency of the Council of the EU failed to secure a qualified majority for the provisional agreement on the Directive.

²⁰ Article 2 of the Commission’s proposal.

²¹ Recital 51.

²² A Cerrahoglu, ‘Defining the Scope of a Corporate Sustainability Due Diligence Directive: Concerns, High-Impact Sectors and Financial Institutions,’ Nova Centre on Business, Human Rights and the Environment Blog, 15th February 2023.

human rights and environmental impacts.²³ The European Coalition for Corporate Justice, a coalition of civil society organizations and NGOs from across Europe, considers the changes to the scope disappointing, expecting that all companies should be held accountable for human rights and environmental violations.²⁴

According to Article 37, the Directive outlines a cascading timeline. Three years after entry into force, companies with more than 5000 employees and more than 1500 million EUR in turnover will have to comply. Four years after entry into force, companies with more than 3000 employees and more than 900 million in turnover will be obliged to comply. Finally, those companies with more than 1000 employees and turnover of more than 450 million EUR will fall under the Directive five years after the entry into force of the law.

V. Companies' Obligations

The Directive mandates various obligations that companies must fulfil as part of their due diligence, such as integrating due diligence into their policies and risk management systems²⁵. These due diligence policies should be developed following prior consultation with the company's employees and their representatives and must outline the company's approach toward due diligence. Additionally, the policy has to be accompanied by a code of conduct that specifies the rules and principles to be followed across the company and its subsidiaries, as well as by its direct or indirect business partners where applicable. The policy should also describe the processes implemented to integrate due diligence into relevant policies and to conduct due diligence effectively.²⁶

Human rights and environmental due diligence must be carried out based on a risk-based approach. On the one hand, the text of the Directive aims to give necessary explanations in this respect, stating, as an example in recital 41, that 'when identifying, and assessing adverse impacts, the company should take into account, based on an overall assessment, possible relevant risk factors, including company-level risk factors, such as whether the business partner is not a company covered by this Directive; business operation risk factors; geographic and contextual risk factors, such as the level of law enforcement concerning the type of adverse impacts; product and service risk factors; and sectoral risk factors.'²⁷ On the other hand, the wording of the Directive is often rather vague. The same Recital 41 states that to identify and assess actual or potential adverse human rights and environmental impacts, companies need to use appropriate methods and resources without providing substantial clarity on what is meant by "appropriate methods". There is still hope that in accordance with Article 19, the general guidelines and sector-specific guidelines that are supposed to be issued by the European Commission will provide necessary clarifications.

²³ Ibid.

²⁴ See European Coalition for Corporate Justice, 'Reaction CSDDD endorsement brings us 0.05% closer to corporate justice' < <https://corporatejustice.org/news/reaction-csddd-endorsement-brings-us-0-05-closer-to-corporate-justice/>> accessed 6 May 2024.

²⁵ Additionally, according to recital 38, as part of their obligations, companies should 'identify and assess, where necessary prioritise, prevent and mitigate as well as bring to an end and minimise the extent of actual and potential adverse human rights and environmental impacts, provide remediation in relation to actual adverse impacts, carry out meaningful engagement with stakeholders, establish and maintain a notification mechanism and complaints procedure, monitor the effectiveness of the measures taken in accordance with the requirements that are provided for in this Directive and communicate publicly on their due diligence.'

²⁶ Recital 39.

²⁷ According to Recital 24, 'Adverse human rights and environmental impacts might occur in companies' own operations, operations of their subsidiaries and of their business partners in the chains of activities of the companies, in particular at the level of raw material sourcing and manufacturing. For the due diligence to have a meaningful impact, it should cover human rights and environmental adverse impacts generated throughout the majority of the life cycle of production, distribution, transport and storage of a product or provision of services, at the level of companies' own operations, operations of their subsidiaries and of their business partners in their chains of activities.'

Worth mentioning is that when evaluating appropriate measures to prevent or adequately mitigate adverse impacts, it is necessary to consider the so-called ‘level of involvement of the company in an adverse impact’.²⁸ The level of involvement depends on whether the adverse effect is caused solely by the companies, or jointly with other legal entities, or caused only by their business partners in their chains of activities. For example, companies must take appropriate measures when it comes to prevention or mitigation of the adverse impacts that they cause themselves or jointly with their subsidiaries or business partners. In situations where the adverse impact is caused only by a companies’ business partner in their chains of activities, ‘they should still aim to use their influence to prevent or mitigate the adverse impact caused by their business partners or to increase their influence to do so.’²⁹

VI. Non - Compliance with the Directive

EU Member States must designate a public supervisory authority to verify compliance with the obligations set by the Directive. Investigations may be initiated by supervisory authorities on their own initiative or based on substantiated concerns communicated to them.³⁰ They shall be empowered, among other things, to order a company to cease infringements or provide appropriate remediation, as well as even impose penalties. According to Article 27, Member States shall determine the rules on penalties, including pecuniary penalties. The penalties shall be effective, proportionate and dissuasive. The Directive states that when deciding whether to impose penalties, several elements must be taken into consideration, such as the nature, gravity and duration of the infringement, or any collaboration with other entities. The Directive prescribes that the ‘maximum limit of pecuniary penalties shall be not less than 5% of the net worldwide turnover of the company in the financial year preceding the fining decision.’ It is uncertain how the sanctions will be imposed on third-country companies which are supervised by the national authorities of the country where they have a branch or where they generate most of their net turnover in the EU. Since public authorities cannot conduct investigations beyond the territory of the EU, the question arises how Member States will enforce penalties in practice.³¹

The Directive also foresees civil liability for not fulfilling the obligations prescribed in Articles 10 (preventing potential adverse impacts) and 11 (bringing actual adverse impacts to an end). According to the adopted text, companies should be liable if two conditions are met: if damage was caused through intent or negligence, and when the damage was caused to natural or legal person’s interests that are protected under national laws. The second condition can serve as a limitation for some types of claims, such as when there is no clear natural or legal person harmed, or when litigation is about group rights that are exercised collectively.³² Moreover, to establish civil liability, the causation must be present at the Member State level based on national legislation. The literature criticizes the limitation of liability based on causation, as this undermines the tortfeasor’s incentive to internalise negative externalities, such as low-probability consequences of their actions. This is linked to the doctrine of foreseeability, which limits causation. Additionally, companies will have sufficient leeway to escape liability due to the vague language of the Directive.³³

For example, recital 44 states that ‘where a company cannot prevent, mitigate, bring to an end or minimise the extent of all the identified actual and potential adverse impacts at the same time to the full extent, it should prioritise the adverse impacts based on their severity and likelihood.’ This possibility for the company to prioritize the adverse impacts based on vaguely defined criteria significantly weakens the provisions on civil liability. Furthermore, a company cannot be held liable if the damage was caused only by its business partners in its chain

²⁸ Recital 45.

²⁹ Ibid.

³⁰ Article 25.

³¹ N Bueno, et al. ‘The EU Directive on Corporate Sustainability Due Diligence (CSDDD): The Final Political Compromise’ < <https://www.cambridge.org/core/journals/business-and-human-rights-journal/article/eu-directive-on-corporate-sustainability-due-diligence-csddd-the-final-political-compromise/9731DFA73A2D98D2B8B71BEDF68CEDD1#fn22> > accessed 15 June 2024.

³² The Danish Institute for Human Rights 2024, supra note 17.

³³ A M Paces, *Civil Liability in the EU Corporate Sustainability Due Diligence Directive Proposal: A Law & Economics Analysis* (Law Working Paper N° 691/2023).

of activities, referring to direct or indirect upstream or downstream partners of the company. The question then arises whether the failure to perform due diligence is sufficient to cause the damage jointly with the business partner that caused it, thereby triggering the joint and several liabilities of the company.

Reading the text of the Directive, one could think that companies could be severely punished since it foresees penalties that can be imposed by the supervisory authorities. Furthermore, there is a possibility for affected persons to seek compensation in civil proceedings. However, after a more careful examination of the provisions, the Directive will most likely allow companies to still escape liability.

VII. CONCLUSION

When the Commission's proposal was released, scholars expressed mixed views. Chantal Mak stated that due diligence laws 'inspire new ways of seeing the role of law in developing sustainable business practices',³⁴ while Richter and Passador referred to the law as generic, contradictory, and vague.³⁵ Lafarre furthermore questioned the effectiveness of the enforcement of corporate sustainability due diligence rules.³⁶ By and large, this initial assessment of the proposal seems to be accurate considering the final text of the Directive.

On the positive side, this is a historic moment since CSDDD is the first EU-wide legislation according to which it will be mandatory for EU and non-EU companies falling within the scope of the Directive to fulfil human rights as well as environmental obligations. Analysing the final text, it seems that the Directive places serious obligations on companies—they will be obliged to show that they have undertaken all appropriate measures to effectively identify risks and prevent, terminate, mitigate, address or remediate actual and potential adverse human rights and environmental impacts. The Directive also foresees an obligation to adopt and put into effect a transition plan for climate change mitigation.

However, in my view, the adopted text of the Directive has many imperfections. It has a rather limited scope, excluding some downstream activities and applying only to companies with more than 1,000 employees and a net worldwide turnover of more than 450 million EUR.

Additionally, it excludes the financial sector from due diligence obligations concerning downstream activities. Moreover, the Directive contains vague and weak provisions, leaving room for the companies to escape liability. Given these significant limitations, there are serious concerns whether it will indeed foster respect for human rights and environmental protection among companies. There is a risk that the law serves a symbolic purpose and that companies will view it as another mere tick-the-box exercise to comply with an additional regulation.

³⁴C Mak, 'Corporate sustainability due diligence: More than ticking the boxes?' 29 (3) Maastricht journal of European and Comparative law, 301.

³⁵M R Stella, and M L Passador, *Corporate Sustainability Due Diligence: Supernatural Superserious* (Bocconi Legal Studies Research Paper, December 2022).

³⁶A Lafarre, 'The Proposed Corporate Sustainability Due Diligence Directive: Corporate Liability Design for Social Harms' 34 (2) European Business law review, 213.