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March 14, 2022

On February 23, 2022, the European Commission published its long-awaited proposal for a directive on corporate sustainability due diligence and annex, with an aim to "foster sustainable and responsible corporate behaviour throughout global value chains." If adopted, the directive will require certain companies to conduct due diligence on their own operations, as well as those of their subsidiaries and commercial partners. Because of the extensive scope of the obligations proposed, the draft text is seen as a milestone in policymakers' attempts to regulate businesses' impact on human rights and the environment.

Specifically, companies will need to:

- Maintain corporate policies on due diligence.
- Conduct due diligence.
- Take steps to prevent adverse impacts on human rights and the environment.
- Establish a complaints procedure.
- Report on due diligence.

The idea is that this due diligence will help to identify and prevent adverse human rights and environmental impacts, with various EU member state supervisory authorities being able to investigate and impose sanctions on companies failing to comply.

Below, Cooley's international products and public international law specialists examine the proposal and its practical implications for product manufacturers and their directors.

Background

Regulators and companies are becoming increasingly interested in environmental, social and governance, or ESG, issues, including in the products sphere. (For more information, refer to our January 2022 and March 2022 Productwise blog posts.)

Against this backdrop, the European Commission began consulting on a "sustainable corporate governance" initiative in October 2020. There were also calls from the EU member states and the European Parliament for EU legislation on mandatory "cross-sector corporate due diligence along global value chains."

Separately, various countries across Europe have introduced or are considering their own national legislation on due diligence in the areas of sustainability and human rights. If adopted, the new EU proposal will use a harmonized approach, which is likely to be easier for businesses to manage, given the global nature of most large companies' operations across Europe.

Who would the new rules apply to?

The new rules would apply to EU and non-EU companies of a certain size, including product manufacturers. In particular, the directive would apply to:

- EU companies with more than 500 employees and global revenue of more than 150 million euros.[1]
- EU companies with more than 250 employees and global revenue of more than 40 million euros, and which generate more than half of their revenue in certain "high-impact" sectors, namely textiles, agriculture and resource extraction.
- Non-EU companies with EU revenue of more than 150 million euros.[2]
- Non-EU companies with EU revenue of between 40 and 150 million euros, and which generate more than half of their revenue in one or more of the high-impact sectors.[3]

What are the key requirements being proposed?

The key obligations on companies are:

- **Maintaining corporate policies on due diligence (Article 5):** Any company in scope must have in place a "due diligence policy" that sets out its approach and processes with respect to identifying any harmful human rights or environmental practices (known as "adverse impacts") in its value chain, as well as a code of conduct it will follow when conducting such due diligence.
- **Conducting due diligence and monitoring (Articles 6 and 10):** Companies must continuously monitor actual or potential adverse impacts arising from their own operations, or the operations of their subsidiaries or any companies with whom they have an established business relationship.
- **Preventing adverse impacts (Articles 7 and 8):** Companies must take steps to prevent or mitigate any potential adverse environmental or human rights impacts and end or minimize the extent of any actual adverse impacts. This could involve seeking contractual assurances from a business partner.
- **Establishing complaints procedures (Article 9):** The proposal requires companies to establish and maintain effective procedures by which any third parties can submit complaints to the company regarding adverse supply-chain impacts.
- **Reporting on due diligence (Article 11):** Companies must publish an annual statement on their website (to the extent they are not already required to do so via their annual reports) on the due diligence matters covered by the proposed directive.

Which 'adverse impacts' would companies need to identify and prevent?

Rather than specifying the adverse impacts by way of new definitions or criteria, the European Commission has taken the approach of referring to various instruments of international law.

For example, one adverse human rights impact listed in the annex to the directive is any "violation of the prohibition of arbitrary or unlawful interference with a person's privacy, family, home or correspondence and attacks on their reputation, in accordance with Article 17 of the Universal Declaration of Human Rights."[4]

In practice, this means companies will need to train the executives in charge of their supply chains to understand and verify compliance with the various human rights and environmental treaties and instruments listed in the annex to the directive.

Consequences of non-compliance

Under the proposal, national regulators will be empowered to investigate companies suspected of non-compliance, issue orders requiring a company in breach to take remedial action and impose fines.[5] Member states also will be required to establish civil liability regimes – if they do not already exist – whereby companies could be liable for damages if their failure to comply results in harm to individuals.[6]

Provisions affecting company directors

Directors of companies in scope of the directive would be responsible for putting in place and overseeing the due diligence obligations set out above, particularly with respect to corporate policies on due diligence.[7]

Directors of EU companies in scope also would need to take into account the consequences their decisions might have on "sustainability matters," including with respect to human rights and the environment.[8]

Next steps

The proposed directive has now passed to the European Parliament and the European Council for their review. They could adopt the proposal in full or (more likely) suggest amendments before adopting. However, there are reportedly large areas of disagreement among the institutions, as well as indications that a final text might not be agreed upon during the current European Parliament and European Commission presidencies, which will both change in 2024. Once the directive is adopted, EU member states would have two years to transpose it into their national law.

We will be closely following this development and how it might impact our clients' businesses. For questions about this article or the topic of ESG in products generally, please contact a member of the Cooley team listed below.

Notes

1. Article 2(1)(a)
2. Article 2(2)(a)
3. Article 2(2)(b)
4. Annex, Part I, paragraph 5
5. Articles 18 and 19
6. Article 22
7. Article 26
8. Article 25

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