



Directive on Corporate Sustainability Due Diligence

On 23 May 2022, the [feedback period](#) closed for the proposal (hereinafter: the Proposed Directive) of an EU Directive on Corporate Sustainability Due Diligence (CSDD), which was published late February 2022. The Proposed Directive of the European Commission (hereinafter: the Commission) introduces, among other things, a human rights and environmental due diligence obligation for certain companies and a civil liability for failing to exercise due diligence. The Proposed Directive can be considered as an important development in efforts made by the European Union (hereinafter: the EU) to achieve a climate-neutral and green economy. In this article we further discuss the Proposed Directive.

### *Background and aim*

The Proposed Directive is part of the European ‘Green Deal’, a series of policy initiatives by the Von der Leyen Commission with the overarching aim to make Europe climate neutral by 2050. One aspect of the Green Deal is the further integration of sustainability into the corporate governance framework (in other words: into the way companies are managed and supervised). This is why the Commission launched a consultation on its ‘Sustainable Corporate Governance’ initiative, from 26 October 2020 to 8 February 2021. One of the aims of this initiative is to improve the EU regulatory framework on company law and corporate governance. The Proposed Directive is partly the result of that consultation.

The aim of the Proposed Directive is to ensure that companies operating in the internal market contribute to sustainable development and the sustainability transition of economies and societies through the identification, prevention and mitigation, bringing to an end and minimisation of potential or actual adverse effects on human rights and the environment resulting from companies’ own operations, their subsidiaries and their value chains.

### **Scope**

The scope of the Proposed Directive includes both companies incorporated in EU Member States and companies incorporated in third countries, provided that they meet the following thresholds.

#### **EU companies**

- an average of more than 500 employees and a net turnover of more than EUR 150 million.
- an average of more than 250 employees and a net turnover of more than EUR 40 million, provided that at least 50% of the net turnover was generated in one or more of the so-called high-impact sectors such as textiles, clothing, agriculture, forestry, fishing, the manufacture of foodstuffs, the wholesale trade in agricultural raw materials and the extraction of mineral resources. These sectors have a high risk of ‘negative effects’, which we will discuss below.

This would involve almost 12,800 EU companies.

#### **Non-EU companies**

- in the EU, with a net turnover of more than EUR 150 million.
- in the EU, with a net turnover of more than EUR 40 million, provided that at least 50% of the net turnover was achieved in one or more of the high-impact sectors.

This would involve almost 4,000 non-EU companies.

The Proposed Directive does not distinguish between listed and non-listed companies, and small and medium sized enterprises (SMEs), considering the aforementioned criteria, do not fall directly within the scope. However, if SMEs do business with companies covered by the Proposed Directive, it is expected to affect them indirectly.

## Substantive analysis

The Proposed Directive aims to introduce major changes in laws and regulations and below we will highlight some of the most important changes. The following topics will be highlighted: (i) the companies' obligation to exercise due diligence, (ii) the combat against climate change (mandatory), (iii) the legal basis of liability for companies, (iv) the duty of care for executive and supervisory directors, and (v) the options for sanctions in the event of violations.

### (i) Due diligence

The most innovative aspect of the Proposed Directive is that it requires Member States to ensure that companies exercise due diligence in respect of human rights and the environment by implementing the following six measures:

1. Incorporating due diligence into their policies, to be updated annually.
2. Identifying actual or potential adverse impacts on human rights and the environment, potentially requiring appropriate measures at three levels: in their own operations, in their subsidiaries' operations, and in the operations of established business relationships.
3. Preventing and mitigating potential adverse impacts on human rights and the environment, and bringing to an end and minimising actual adverse impacts. This could include preparing and implementing a preventive action plan and trying to obtain contractual guarantees from business relationships. Companies are thus required to bring to an end the actual adverse effects, or at least to reduce the extent of the adverse effects to a minimum.
4. Establish and maintain a complaints procedure to enable certain individuals and organisations to complain to companies if they have legitimate concerns about actual or potential adverse human rights impacts and adverse environmental impacts in relation to their own operations, the operations of their subsidiaries and their value chains.
5. Monitoring the effectiveness of their due diligence policy and measures through periodic reviews, with which the due diligence policy should be updated in accordance with the results of this evaluation.
6. The annual publication on the website of information on due diligence.

### (ii) Combating climate change

The Proposed Directive also contains some obligations for companies on combating climate change. EU companies with on average of more than 500 employees and a net turnover of more than EUR 150 million and non-EU companies with a net turnover of more than EUR 150 million in the EU must adopt a plan to ensure that the company's business model and strategy are compatible with (a) the transition to a sustainable economy, and (b) limiting global warming to 1.5 °C, in line with the Paris Agreement. This plan should particularly identify the extent to which climate change constitutes a risk to, or is the effect of, the company's operations.

If climate change is found to be a significant risk for, or a significant effect of, the operations of the above companies, those companies' plans must include emission reduction objectives.

The variable remunerations for directors or supervisory directors of the companies referred to here are sometimes linked to the contribution of directors or supervisory directors to the companies' business strategy, long-term interests and sustainability. The Proposed Directive stipulates that, in this case, when setting the variable remunerations, companies should take due account of compliance with the abovementioned obligations on combating climate change.

### **(iii) Civil liability**

Under the Proposed Directive, a company will also be liable for damages if it fails to prevent, mitigate and/or bring to an end potential adverse effects of its operations, and damage has occurred as a result of that failure. Under certain circumstances, companies are not liable for damage caused by the operations of an indirect partner with whom the company has an established business relationship.

In assessing the existence and extent of liability, due account should be taken of (a) the company's efforts to comply with any related remedial measures required by a supervisory authority, (b) any investments made and any targeted support provided, and (c) its collaboration with others to address the adverse impacts in its value chains.

The liability of a company should be without prejudice to civil liability of both its subsidiaries and all direct and indirect business partners in the value chain. Liability under the Proposed Directive also does not mean that companies cannot be held liable under other EU or national rules.

### **(iv) Duty of care of directors and supervisory directors**

The original idea was to introduce personal liability for directors to further integrate sustainability into corporate governance. This was abolished - partly - because of criticism of the effectiveness of such liability. Directors might be held accountable if they fail to act in the long-term interests of the company (and its stakeholders), but shareholders (who might actually be guided by short-term effects) would be spared. In addition, personal liability for directors was deemed undesirable because it could lead to legal uncertainty, as directors would be unable to properly judge in which situations they would or would not be liable. This is one of the reasons why the Proposed Directive opts for liability of the entire company (see above under (iii)).

The Proposed Directive does, however, introduce a duty of care for directors, supervisory directors and other persons performing similar functions within EU companies. This obligation means that, in performing their duties, these persons must take into account the consequences of their decisions for sustainability matters, human rights, climate change and the environment, including in the short, medium and long term. If they fail to do so, the Proposed Directive stipulates that all national statutory and administrative provisions on any breach of duties by these persons apply to the breach of the duty of care. This could mean that a managing director or supervisory director runs the risk of being held (personally) liable if he or she acts contrary to the duty of care.

It should be noted here that at first sight, the duty of care appears to increase the statutory duties of directors and supervisory directors, however, one could argue whether the duty of care in the Netherlands also results in an additional liability risk. After all, directors and supervisory directors in the Netherlands must already serve the corporate interest in performing their duties and must always take the interests of all stakeholders into account. The duty of care in the Proposed Directive does, however, provide for a more specific interpretation of the open standard for directors' liability in the Netherlands. This could possibly lower the threshold for directors' liability. We are curious to see how the Dutch legislator and the courts will deal with this.

### **(v) Supervisory authorities may impose penalties**

Finally, the Proposed Directive stipulates that each EU Member State must designate at least one supervisory authority to supervise compliance with national statutory obligations originating from the Proposed Directive. Both natural persons and legal entities are entitled to submit substantiated concerns to a supervisory authority if, based on objective circumstances, they have reason to believe that a company fails to comply with its obligations under the Proposed Directive.

The supervisory authorities have the power, inter alia, (i) to request information and carry out investigations related to compliance with the obligations set out in the Proposed Directive, (ii) to order the cessation of infringements of the national provisions adopted pursuant to the Proposed Directive, abstention from any repetition of the relevant conduct and, where appropriate, remedial action proportionate to the infringement and necessary to bring it to an end, (iii) to grant a company an appropriate period of time in which to take remedial action, (iv) to ultimately impose pecuniary sanctions based on the turnover of the company concerned, and (v) to adopt interim measures to avoid the risk of severe and irreparable harm. All sanctions imposed by the supervisory authorities should be 'effective, proportionate and dissuasive'.

## Criticism and EU Scrutiny Board

The Proposed Directive has not been received without criticism. Among other things, the combination of open standards and strict liability is considered to be undesirable. Several parties also fear that the Proposed Directive will lead to an increased regulatory burden, especially for SMEs, while the impact of the Proposed Directive would be minor. However, the most fundamental criticism is that the Proposed Directive - especially in this day and age - lacks ambition when it comes to combating climate change. Only one article in the entire Proposed Directive is devoted to combating climate change (article 15). It is seen as disappointing that the article entails obligations that are (expectedly) rather vague, which casts doubt on its effectiveness. This while - given the time pressure - effective legislation is required to combat climate change. In that respect, the Proposed Directive is severely lacking, according to critics.

Furthermore, the criticism of the Proposed Directive is not new. For example, the EU Scrutiny Board, the European body that scrutinises EU legislation at an early stage, twice issued a negative opinion on the Commission's impact assessment. In this impact assessment, the Commission assessed whether there is a need for regulation and how such regulation should be designed. Despite the fact that, in principle, a positive opinion from the EU Scrutiny Board is required before a proposal for a directive can move on to the adoption phase, it has been decided to push through the Proposed Directive despite these negative opinions.

## Current status

Despite the criticism, chances are that the final directive will broadly align with the Proposed Directive. It is now up to the European Parliament and the Council of the EU to decide on the Proposed Directive, which is not expected to happen before 2023. Afterwards, Member States will then have two years to implement the final directive in their national legislation. The rules, applicable to companies that only fall within the scope of the Directive Proposal because they operate in high-impact sectors, will become applicable four years after the start of the implementation period. We will therefore have to be patient 'for a while' before we can assess the effectiveness of the final directive.

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