



Deloitte Legal Newsflash

Climate & Energy

Corporate due diligence to protect human rights and the environment: is your company ready?

In recent years, more and more businesses in the EU have been deploying due diligence processes. Companies understand the importance of such processes for their customers and investors who are becoming increasingly aware of all sustainability aspects. If instituting due diligence procedures can provide companies with a competitive advantage and help avoid reputational risks, these processes remain, to this day, entirely based on voluntary standards and do not result in any legal certainty.

On 23 February 2022, the European Commission (EC) consequently adopted a [Proposal for a Directive on corporate sustainability due diligence](#) (the Proposal) to prevent the possible detrimental impact of companies and their value chain on the environment, human rights and the climate. The aim is to oblige the targeted companies, as defined in Article 2 of the Proposal (Companies), to set up and carry out due diligence measures in their own operations and their value chain to identify and prevent human rights violations and environmental risks in the production of goods and services.

Context and key elements

The Proposal fits within the bigger framework of, amongst other, the EU Green Deal and the EU Action Plan on Human Rights and Democracy.

What makes this Proposal impactful is that obligations are imposed on Companies throughout their entire value chain. This includes their own operations, their subsidiaries, as well as their established direct and indirect business relationships. The EC recognises that Companies cannot guarantee these obligations in all circumstances but should take the appropriate measures which can reasonably be expected to result in preventing or

minimising the adverse impact in each specific case. The main obligations in the Proposal should be seen as ‘obligations of means.’

Scope

To establish whether a Company falls within the scope of the Proposal, Article 2 makes a distinction between Companies that are formed in accordance with the legislation of a Member State (formed inside the EU or EU Companies) or of a third country (formed outside the EU or non-EU Companies):

- **EU Companies** are targeted if they have (i) more than 500 employees and (ii) make at least EUR 150 million in annual turnover. The Proposal, once transposed into national law, will apply immediately to this first category of Companies.
- The Proposal will also apply to **EU Companies in high-impact sectors** (such as textiles, mining, agriculture and raw materials) that make more than EUR 40 million in annual turnover and have at least 250 employees on average. The rules of the Proposal, once transposed into national law, will apply (in two years’ time) to this second category of EU Companies, in order to allow for a longer adaptation period. In addition, the due diligence obligations of these Companies will be limited to severe impacts relevant to their sector;
- **For non-EU Companies** only a turnover threshold of over EUR 150 million applies and the number of employees is not taken into account.

Small and medium-sized enterprises (SME) are left out of the scope of the Proposal in order to protect them from additional regulatory burden. However, they may still be affected if they are active in the value chains of Companies that do fall within the scope of the Proposal.

Due diligence process

Article 4 (and preamble 16) of the Proposal contains the due diligence rules that would apply to the Companies. The due diligence process covers six steps that are explained in Articles 5 to 11 of the Proposal. In order to facilitate compliance with these due diligence requirements, the EC will create and provide 'Model contractual clauses' and guidelines on how Companies should fulfil their due diligence obligations.

The six steps of the due diligence process can be summarised as follows :

(1) Integrating due diligence into companies’ policies

Article 5 of the Proposal requires that the Companies integrate due diligence into all corporate policies and have in place a due diligence policy, which must be updated annually. The due diligence policy of the Companies must include:

- (a) a description of the company’s approach, including in the long term, to due diligence;
- (b) a code of conduct describing rules and principles to be followed by the company’s employees and subsidiaries;
- (c) a description of the processes put in place to implement due diligence.

(2) Identifying actual and potential adverse human rights and environmental impacts

Article 6 of the Proposal lays down the obligation for Companies to take appropriate measures to identify actual or potential adverse human rights and environmental impacts (such as defined in the Proposal) in their own operations, with their subsidiaries and at the level of their established direct or indirect business relationships in their value chain.

Further, Companies that fall under category 2 in the high-impact sectors, must identify actual or severe adverse impacts relevant to the sector in question. In order to allow for a comprehensive identification of adverse impacts, such identification shall be based on quantitative and qualitative information.

(3) Preventing, ceasing and ending (or at least minimising) actual and potential adverse human rights and environmental impacts

Once potential and actual adverse human rights and environmental impacts have been identified, Companies must take appropriate measures to prevent these identified adverse impacts, or adequately mitigate those impacts where prevention is not possible or requires gradual implementation. Furthermore, Article 8 of the Proposal establishes that Companies must take appropriate measures to bring to an end actual adverse human rights and environmental impacts. Where such an adverse impact cannot be brought to an end, Companies must minimise the extent of the impact.

The Proposal also provides specific actions to be taken by the Companies, such as the development and implementation of a prevention action plan in consultation with the affected stakeholders, with reasonable and clearly defined timelines for action and qualitative and quantitative indicators for measuring improvement.

(4) Assessing and monitoring the effectiveness of their due diligence policy and their measures

The Proposal introduces the obligation for Companies to periodically assess the implementation of their due diligence measures, to ensure that adverse impacts are properly identified and that preventive or corrective measures are implemented.

(5) Reporting

The Proposal does not seemingly introduce new reporting obligations. Article 11 of the Proposal, however, establishes the obligation for Companies that are not subject to reporting requirements under the Commission's Proposal for a Corporate Sustainability Reporting Directive (the CSRD Proposal) to report on the matters covered by the CSRD and publish their due diligence in an annual statement on their website.

(6) Providing remediation by establishing and maintaining a complaints procedure

The Proposal also provides for a complaints procedure to be set up by the Companies. Through this procedure, interested parties will have the possibility to directly submit complaint(s) to the Companies in case of legitimate concerns regarding actual or potential adverse human rights impacts and adverse environmental impacts.

Combating climate change

In order to verify whether the Companies' commitments effectively contribute to combating climate change, Article 15 of the Directive Proposal sets out the obligation for Companies to adopt a plan to ensure that the business model and strategy of the Company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement. The Company should include emission reduction objectives in that plan, if climate is or should have been identified as a principal risk for, or a principal impact of, the Company's operations. This obligation is closely intertwined with the obligations set out in the CSRD Proposal.

Enforcement: Sanctions and Civil Liability

The enforcement mechanism is built on administrative enforcement on the one hand and civil liability on the other hand. The Commission leaves it to the Member States to lay down the rules on sanctions and enforcement of those rules if the measures set out in the Proposal are infringed:

- The rules on administrative sanctions will be initiated by the competent supervisory authority and imposed by the judicial authority of the Member States. The penalties provided for must be effective, proportionate, dissuasive, shall be based on the Company's turnover and will be published;

- Concerning civil liability, Companies will be liable for certain damages as defined in Article 22 of the Proposal. The Proposal does not stipulate who has to prove that the Company's actions were reasonably adequate since this is left to be determined by national law. In addition, the Proposal stipulates that the civil liability of the Company for damages is without prejudice to (i) the civil liability of its subsidiaries or the respective civil liability of direct and indirect business partners in the value chain, and to (ii) Union or national rules on civil liability related to adverse human rights impacts or to adverse environmental impacts that provide for liability in situations not covered by or providing for stricter liability. The civil liability related to adverse environmental impacts in the Proposal will be complementary to the Environmental Liability Directive.
- Concerning criminal liability, it is not provided for in the Proposal but Member State will have the ability to adopt more stringent measures in their transposition into national law.

Directors, representatives and authorities

The Proposal requires each targeted Company to appoint a natural (or legal) person as its authorised representative. Furthermore, directors will be responsible to exhibit and manage the due diligence actions of their Companies. Directors will also have to make sure to adapt the corporate strategy of their Company to take into account the identified actual and potential adverse impacts on human rights and the environment. If necessary, they will consider relevant input from stakeholders and civil society organisations.

In addition, the Proposal contains an obligation for the Member States to designate one or more supervisory authorities (national administrative authorities) to oversee the application of the rules, ensure compliance by Companies with their due diligence obligations and the proper enforcement of the Proposal Directive. In Belgium it is not yet decided whether this will be a new authority or if an existing authority will become competent in this matter. With respect to Belgium's division of powers and the likelihood that there will be more than one supervisory authority, these authorities' respective competencies will have to be clearly defined and they will have to cooperate closely and effectively with each other. The powers of those authorities are laid down in Article 18 of the Proposal. They can, notably, request information, carry out investigations, take remedial proportionate actions, impose pecuniary sanctions, adopt interim measures, ...

In addition, the Commission will set up a European Network of Supervisory Authorities to help with the implementation of the obligations of the Proposal into national law and to facilitate and ensure the coordination and alignment of regulatory, investigative, sanctioning and supervisory practices, and the sharing of information among supervisory authorities.

Where 'pain points' are discovered, Companies will have to take appropriate measures to address the issues across their operations and value chains and provide compensation for the victims. The Proposal provides for its enforcement with fines for non-compliance and specific obligations for the Companies and their directors with regard to human rights and environmental law. It also introduces a civil liability regime that will enable victims to sue companies for damages that could have been avoided by exercising due diligence. Companies will have to align their business model and strategy to comply.

Next steps

The Proposal is currently undergoing the legislative process. Therefore, it is not yet binding and can still be amended with the respective readings of the Council of the European Union and the European Parliament. Once adopted, the Proposal will have to be transposed into national law in the years after its

adoption (generally, this process takes up to 2 years). The question whether the transposition of this Proposal in Belgium would take place at the federal level (in the form of an ‘act’) or at the local level (in the form of a ‘decree’ and ‘ordinance’) remains currently unanswered considering the many different competencies contained in the proposal.

There is little doubt that this Directive, once adopted, will impact the businesses of many companies in the near future. Our Deloitte Legal climate & energy team can assist you to comply with the upcoming legislation.

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