

LOOMING EU HUMAN RIGHTS AND ENVIRONMENTAL DUE DILIGENCE DIRECTIVE WILL HAVE GLOBAL IMPACT

24 February 2022 | Insight
Legal Briefings

As Brussels' milestone bid to press major firms to audit their social impact takes shape, we assess the implications

Slightly less than one year after the Commission received backing from the European Parliament to move forward on human rights and environmental due diligence (we previously reported on this development [here](#) and [here](#)), the European Commission adopted a proposal for a Directive on corporate sustainability due diligence, yesterday (23 February 2022).

The Directive comprises 32 Articles which collectively aim to create a legal framework that [according to the EU Commission](#) seeks to promote legal certainty and establish a level playing field for businesses operating in Europe. The EU Commission moreover suggests that the Directive will provide greater transparency on business' operations for consumers and investors and that the framework established under the Directive will advance the green transition and protect human rights across the globe.

In the remainder of this note we briefly consider the key requirements imposed under the Directive as well as the significant consequences for the entities which are affected by the proposed regime.

From the outset it is worth bearing in mind that the Directive currently does not impose any legal obligations. Before it enters into force, the proposal will be presented to the European Parliament and the Council for approval. Once adopted, the Directive shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.¹ EU Member States will after that have two years to transpose the Directive into national law and communicate the relevant texts to the Commission.

SUBJECT MATTER, SCOPE AND KEY DEFINITIONS (ARTICLES 1,2 AND 2)

The Directive establishes the minimum threshold requirements with which certain companies must comply to guard against actual and potential *human rights adverse impacts* and *environmental adverse impacts*.

According to the Directive, adverse human rights impacts² are impacts on protected persons resulting from the violation of one of the rights or prohibitions listed in the Annex, Part I Section 1, (which refer to international human rights conventions listed in the Annex, Part I Section 2). Examples of the listed conventions include the International Covenant on Civil and Political Rights, the Universal Declaration of Human Rights, and the International Covenant on Economic, Social and Cultural Rights.

Adverse environmental impacts³, in turn, are impacts on the environment resulting from the violation of one of the prohibitions or obligations pursuant to the international environmental conventions listed in the Annex, Part II. Examples of the international environmental conventions include the 1992 Convention on Biological Diversity, the Convention on International Trade in Endangered Species of Wild Fauna and Flora, the Basel Convention, and the Montreal Protocol.

The requirements extend to qualifying companies' (as discussed below) own operations as well as the operations of their subsidiaries, and the value chain⁴ operations carried out by entities with whom the company has an established business relationship.⁵

The requirements imposed under the Directive will extend to companies (as defined)⁶ that are incorporated under the laws of EU member states and which exceed the following thresholds:

- a company which has more than 500 employees on average and had a net worldwide turnover of more than EUR 150 million in the previous financial year;
- a company which has more than 250 employees on average and had a net worldwide turnover of more than EUR 40 million with at least 50 per cent of this net turnover being generated in one or more of the listed sectors, including the manufacture of textiles, leather and related products, agriculture, forestry, fisheries, and the extraction of mineral resources (**listed sectors**);⁷
- companies which are formed in accordance with the legislation of a third country, and fulfil one of the following conditions:

- the company generated a net turnover of more than EUR 150 million in the EU;
- the company generated a net turnover of more than EUR 40 million in the EU and at least 50 per cent of its net worldwide turnover was generated in one or more of the listed sectors.⁸

DUE DILIGENCE REQUIREMENTS

Article 4 of the Directive provides that Member States are obliged to ensure that companies conduct human rights and environmental due diligence which satisfy the requirements imposed under Articles 5 to 11.

Under the prescribed framework, Member States must ensure that qualifying companies:

- **integrate due diligence practices into all their corporate policies** and designate authorised representatives.⁹ This must include a due diligence policy which sets out the company's approach to due diligence, a code of conduct, and the processes under which the due diligence will be conducted.¹⁰ The duties imposed under the Directive as well as the company's own policies will extend to the directors of companies. First, directors will be required to take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term.¹¹ Second, the board of directors will be responsible to put in place and oversee the due diligence actions and the company's due diligence policy.
- take **appropriate measures** to identify the **actual** and **potential impacts** of their operations (including those of their subsidiaries and the operations that form part of their value chain) on human rights and the environment. The mechanisms which companies may use include relying on independent reports as well as information gathered through the prescribed complaints mechanism.¹²
- **prevent or adequately mitigate potential adverse impacts**, including actions which cause climate change.¹³ In this regard companies must **bring actual adverse impacts to an end**. Where this is not possible the company must **minimise** their extent the extent of the adverse human rights or environmental impact. In specific circumstances (as stipulated under the Directive) companies are compelled to implement specific measures. Salient examples include the duty to develop and

implement a prevention action plan with reasonable and clearly defined timelines for action and qualitative and quantitative indicators for measuring improvement, request specific contractual assurances from a business partner to promote compliance with the company's code of conduct, or provide targeted and proportionate support for micro, small or medium-sized enterprises (**SME**) with which the company has an established business relationship where compliance with the code of conduct or the corrective action plan would jeopardise the viability of the SME.¹⁴

- **establish and maintain complaint procedures.** The mechanism should enable specific categories of persons to notify a company if the person has a legitimate concern that the company, its subsidiary, or an entity with which the company has a business relationship's activities have an actual or potential adverse human rights or environmental impact. Such persons include persons who are affected or have reasonable grounds to believe that they might be affected by an adverse impact, trade unions and other workers' representatives, and civil society organisations active. Once a person lodges a complaint s/he should be afforded an opportunity to make representations and to receive feedback from the company.¹⁵
- carry out **periodic assessments** and **monitor** the effectiveness of their due diligence policies and measures. Again, companies are expected to assess their operations as well as those of their subsidiaries and the entities with which they have a business relationship.¹⁶ Companies, in this regard, are required to monitor the effectiveness of their attempts to identify, prevent, mitigate, bring to an end and minimise the extent of any human rights and environmental adverse impacts. The assessments must be conducted annually or whenever there are reasonable grounds to believe that significant new risks or impact may arise.
- **publicly communicate** and **report on compliance** with these due diligence requirements by publishing the results on the company's website.¹⁷ The statement shall be published by 30 April each year, and cover the company's performance during the previous calendar year. Member States are also required to ensure that companies which wish to apply for public support certify that no sanctions have been imposed on them for a failure to comply with the obligations of this Directive.¹⁸

SUPPORT FROM THE EU AND MEMBER STATES FOR IMPLEMENTATION OF THE REQUIREMENTS

In an attempt to assist companies in their efforts to comply with the requirements imposed under the Directive, the EU Commission may publish guidance about voluntary model contract clauses.¹⁹ The EU Commission may also issue guidelines on how companies should fulfil their due diligence obligations, including for specific sectors or specific adverse impacts.²⁰

In light of the burden placed on the different stakeholders across the value chain (including on SMEs which will be indirectly affected by the requirements imposed under the directive) Member States may set up and operate individually or jointly dedicated websites, platforms or portals to support company efforts. Member States may also financially support SMEs. Finally, the EU Commission may devise new measures, including facilitation of joint stakeholder initiatives to help companies fulfil their obligations.²¹

ADMINISTRATION, COMPLAINTS, INVESTIGATIONS, PENALTIES AND SANCTIONS

Each Member State shall designate one or more supervisory authorities. The different supervisory authorities will, in turn, form part of the European Network of Supervisory Authorities.²²

The authority in each Member State will be required to supervise compliance with the requirements imposed under the Directive once the obligations are incorporated into the domestic laws of the respective Member State.

Among other things, the designated authority will be mandated to receive substantiated concerns²³ and investigate potential breaches of the requirements imposed under the domestic laws.

If the authority identifies potential breaches of the obligations imposed under the domestic laws, s/he must afford the company a limited time to remedy the breaches. The authority is also entitled to issue stop orders, impose pecuniary sanctions, or impose other interim measures to avoid the risk of severe and irreparable harm.²⁴

The Directive grants Member States the right to stipulate the rules on sanctions which would apply to the infringement of national provisions adopted pursuant to this Directive. The Member States shall, in turn, take all measures necessary to ensure that the sanctions are implemented. The sanctions provided for shall be effective, proportionate and dissuasive. Pecuniary sanctions must be based on the transgressing company's turnover.²⁵

Notably, an order to correct the breach does not preclude the authority from imposing an administrative sanction. It also does not indemnify the company against any action instituted by a third party in case of damages.²⁶ In fact, the Directive obliges Member States to ensure that companies are held liable for damages if they fail to prevent potential adverse impacts, fail to bring actual adverse impacts to an end, or owing to their negligence fail to prevent adverse impacts.²⁷ An exception to this rule would be if, notwithstanding the company's efforts to comply with the requirements imposed under the Directive, the damages were caused by an adverse impact arising from the activities of an indirect partner with whom the company has an established business relationship. The company's actions in these circumstances will serve a mitigating and potentially exculpatory factors.

CONCLUSION

It goes without saying that the requirements imposed under the Directive will have a significant impact on companies which meet the thresholds imposed under Article 2 once the requirements are transposed into the EU members' domestic legislation. The same is however true for companies which do not meet this threshold. While the Directive does not directly impose due diligence obligations on smaller companies, their operations will also be affected if they wish to maintain (and retain) business relationships with large enterprises which are subject to the due diligence obligations. In light of the nature of the obligations imposed under the Directive, companies with operations in other jurisdictions, including Africa, Asia and South America, will also be affected.

It is therefore critical that all businesses use the two-year window (during which EU Member States must domesticate the requirements imposed under the Directive) to get their own houses in order.

1. Article 31 of the Directive.
2. Article 3(b) of the Directive
3. Article 3(c) of the Directive
4. 'value chain' means activities related to the production of goods or the provision of services by a company, including the development of the product or the service and the use and disposal of the product as well as the related activities of upstream and downstream established business relationships of the company. Article 3(g) of the Directive.
5. Article 1(a) of the Directive.
6. It is worth noting that Article 3(a) of the Directive provides a comprehensive definition for "company".
7. Article 2(1) of the Directive.
8. Article 2(2) of the Directive.
9. Article 16 of the Directive.
10. Article 5 of the Directive.
11. article 25 of the Directive.

12. Article 6 of the Directive.
13. Article 15 of the Directive.
14. Articles 7 and 8 of the Directive.
15. Article 9 of the Directive.
16. Article 10 of the Directive.
17. Article 11 of the Directive.
18. Article 24 of the Directive.
19. Article 12 of the Directive.
20. Article 13 of the Directive.
21. Article 14 of the Directive.
22. Article 21 of the Directive.
23. Article 19 of the Directive.
24. Article 18 of the Directive.
25. article 20 of the Directive.
26. Article 22 of the Directive.
27. Article 22(1) of the Directive.

SHARE

[Share to Facebook](#) [Share to Twitter](#) [Share to LinkedIn](#) [Email](#) [Print](#)

Show Share Links

RELATED TOPICS

[Environmental, Social and Governance](#)

FEATURED INSIGHTS

FEATURED INSIGHTS

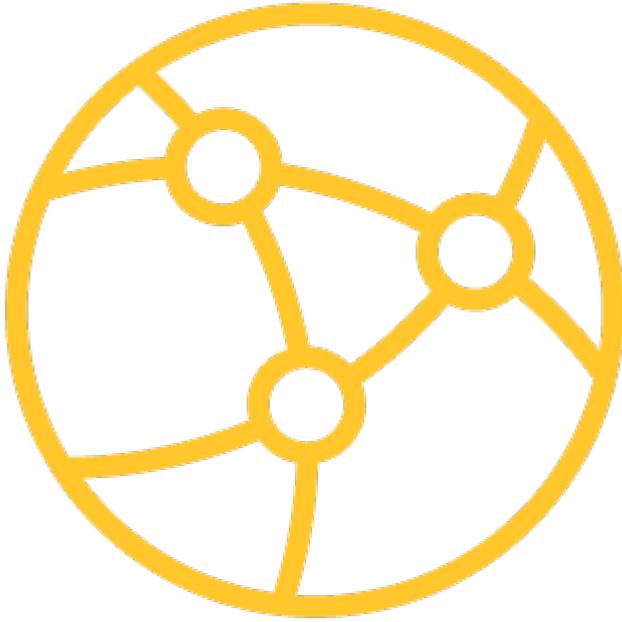
HELPING YOU STAY AHEAD OF THE BIG ISSUES

BROWSE BY:



•

[TECH, DIGITAL & DATA](#)



•

[GEOPOLITICS AND BUSINESS](#)



•

[NEW BUSINESS LANDSCAPE](#)

RELATED ARTICLES



The challenging dimensions of Asia M&A



FSR OUTLOOK 2023: Braving the maelstrom



Are we headed for a Subsidy War? – A new front has opened as de-globalisation marches on

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



ANTONY CROCKETT
PARTNER, HONG
KONG
+852 21014111
Antony.Crockett@hsf.com



SILKE GOLDBERG
PARTNER, LONDON

+44 20 7466 2612
Silke.Goldberg@hsf.com



ERNST MÜLLER
SENIOR ASSOCIATE,
JOHANNESBURG
+27 10 500 2628
ernst.muller@hsf.com



OLIVER ELGIE
SENIOR ASSOCIATE,
LONDON
+44 20 7466 6446
Oliver.Elgie@hsf.com



SYLVIA SCHENK
CONSULTANT,
GERMANY
+49 69 2222 82514
Sylvia.Schenk@hsf.com



**JONATHAN
MATTOUT**
PARTNER, REGIONAL
HEAD OF PRACTICE -
CORPORATE CRIME
AND
INVESTIGATIONS,
EMEA, PARIS
+33 1 53 57 65 41
Jonathan.Mattout@hsf.com