

Corporate Sustainability Due Diligence Proposal and the 2024 European Parliament Elections

Barbara Maria Moreira Dante Santaguida

Abstract: Corporate Sustainability Due Diligence is a current topic on Corporate Responsibility and the protection of human rights and the environment. Recently, the European Commission proposed a directive on this topic and divided opinions mainly regarding the sustainable governance part. Some Member States of the bloc have already adopted rules that embrace the mandatory due diligence process; the proposed directive does not come to eliminate such instruments, but to refine, improve and standardize them. The directive proposal is the first and only of its kind in Europe and with the elections of the European Parliament in the spring of 2024, its discussion and approval becomes urgent.

Keywords: European Commission, Due Diligence, Human Rights, Sustainable Governance, Corporate Responsibility.

Proposta de *Due Diligence* em Sustentabilidade Corporativa e as Eleições para o Parlamento Europeu de 2024

Resumo: A *Due Diligence* de Sustentabilidade Corporativa é um tema atual sobre Responsabilidade Corporativa e proteção dos direitos humanos e do meio ambiente. Recentemente, a Comissão Europeia propôs uma directiva sobre este tema e dividiu opiniões principalmente no que diz respeito à parte da governação sustentável. Alguns Estados-membros do bloco já adotaram regras que abrangem o processo obrigatório de due diligence; a directiva proposta não visa eliminar tais instrumentos, mas sim aperfeiçoá-los, melhorá-los e normalizá-los. A proposta de directiva é a primeira e única do género na Europa e com as eleições para o Parlamento Europeu na primavera de 2024, a sua discussão e aprovação tornam-se urgentes.

Palavras-chave: Comissão Europeia, Due Diligence, Direitos Humanos, governação sustentável, sustentabilidade corporativa.

¹ Graduated in Law from the Regional University of Cariri, **Brazil**. Master in Sustainable Development from the Università degli Studi di Milano, **Italy**. **Contact:** Barbara.santaguida@gmail.com.

Introdução

Corporate Sustainability Due Diligence is a current topic on Corporate Responsibility and the protection of human rights and the environment. Recently, on February 23, 2022, the European Commission published the proposal for a Directive on corporate sustainability due diligence (CSDDD) (EC, 2022). The text of the proposal – which regulates obligations for companies regarding the potential negative impacts caused by their own operations (and those of businesses that interact with the company within its entire value chain) with regard to respect for human rights and the environment – was the subject of disagreements by other European legislative houses (The European Parliament and the Council). It was also the target of criticism from some private institutions operating within the European space and, on the contrary, received positively by other organizations that monitor corporate responsibility. With much of its original text modified, it is difficult to predict how and if there will be an agreement between the Council and Parliament before the 2024 European Parliament elections, but its scope of introducing the obligation of a mandatory due diligence framework must come accompanied by an effective enforcement mechanism.

The basis for the Directive Proposal

It is crucial to begin by elucidating on how the Directive Proposal was formed. The CSDDD is part of the European Commission's sustainable corporate governance initiative. Before this proposal materialized, in December 2019, the Commission launched an ambitious strategic plan - The European Green Deal - with the aim of transitioning its energy matrix, cutting greenhouse gas emissions and becoming the first “carbon neutral” continent by 2050. To achieve this lofty goal there are numerous work fronts and initiatives that contribute as a whole, such as the “Farm to Fork Strategy” or the “Circular Economy Action Plan^{1,2}”.

Corporations, based on the way they are organized and perform their functions, have a primary role in helping to achieve such continental objectives as well as fulfilling the

¹ European Commission (2020) *A new Circular Economy Action Plan - For a cleaner and more competitive Europe*. Brussels Office for Official Publications of the European Communities. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1583933814386&uri=COM:2020:98:FIN>

² Farm to Fork Strategy. Available at: https://food.ec.europa.eu/system/files/2020-05/f2f_action-plan_2020_strategy-info.

sustainability objectives of the United Nations. Therefore, one of the proposals of the European Green Deal is that sustainability should be more embedded within a corporate governance framework.

With sustainability as one of the EU's normative principles (Manners, 2008), some legislative changes were already expected, for example in the directive relating to the obligation of corporations with more than 500 employees to report on the policies they pursue in relation to environmental, social, employee-related, and anti-corruption and bribery matters and respect for human rights, the Non-Financial Reporting Directive or “NFRD”, gave way to a more comprehensive, unified and (hopefully) understandable directive such as the Corporate Sustainability Reporting Directive “CSRD”.

The Taxonomy Regulation, in force since July 2020 (EC, 2023) is also one of the main building blocks of the EU Sustainable Finance Initiative when it comes to classify sustainable investments. At the same time, specific proposals regarding due diligence were being considered. Due diligence practices are part of a key mechanism in the UN Guiding Principles on Business and Human Rights and the OECD Guiding Principles for Multinationals Enterprises and many other international instruments and allow companies to have an overview of different aspects of the company's operations, including global value chains, in order to mitigate, prevent, assess risks, make informed decisions and ensure that all relevant information is uncovered. Due to their importance, these practices must represent an integral part of corporate risk management (European Commission, 2020).

Despite presenting such importance in the transparency of companies' operational activities, due diligence practices, often because they are not mandatory in nature, end up being left in the background. Aware of the consequences of not implementing due diligence, in March 10, 2021, the European Parliament passed a resolution through its own initiative, urging the Commission to begin drafting a legislative proposal addressing corporate due diligence and corporate responsibility. The primary committee responsible for this legislative initiative report was the Committee on Legal Affairs (JURI). In the resolution, the Parliament expresses its endorsement of the enactment of binding legislation. This support arises from the belief that voluntary due diligence standards have not yielded significant progress in preventing human rights and environmental violations or facilitating access to justice. The Parliament's stance is that any forthcoming mandatory Union due diligence framework should encompass all large enterprises subject to Member State laws, whether they are based within the Union or operate within its internal market. Moreover, this

framework should also encompass small and medium-sized enterprises (SMEs) if they are publicly traded.

Slightly earlier, in July 2020, the Commission published an *inception impact assessment* (EC, 2021) on the topic of corporate due diligence and corporate accountability. According to this document, the **first proposal** of the initiative would be to provide clarification that directors, as part of their obligation to act in the best interests of the corporation, must consider the interests of all stakeholders pertinent to the company's long-term sustainability or those who are impacted by it. The stakeholders in question comprehend employees, the environment, and other individuals or entities affected by the company's operations. It is interesting to point out here how the “best interest of the company” is directly bond to concepts as creation of long-term value and the best interest for *all* stakeholders of the company, which is in stark contrast to the principles that formed the basis of the Anglo-American corporate culture of the past century. The **second proposal** involves the introduction of a due diligence obligation, which would necessitate that companies implement measures to address their adverse sustainability effects. These effects could include issues related to climate change, environmental harm, and violations of human rights, within their own operations and throughout their value chain. This would entail the identification and prevention of pertinent risks and the mitigation of any adverse impacts.

The expectation of the Commission by the time of the publication of the impact assessment was to lead to the creation of a proposal for a directive in 2021. Nevertheless, the impact assessment had obtained, for two times a negative opinion from the Regulatory Scrutiny Board. The Regulatory Scrutiny Board (here and after RSB) is an independent body within the Commission that advises the College of Commissioners. It provides central quality control and support for Commission impact assessments and evaluations at the early stages of the legislative process. In this specific case, the RSB found several shortcomings in the impact assessment report: 1) Inadequate presentation of the problem description and lack of convincing evidence regarding sustainability issues for EU businesses, especially SMEs. 2) Insufficient exploration of policy options and evaluation of key policy choices. 3) Incomplete, unbalanced, and non-neutral impact assessment, with insufficient acknowledgment of uncertainty related to benefits. 4) Lack of demonstration of the proportionality of the preferred option. In response to these concerns, the legislative proposal was modified to address the RSB's feedback.

Since the feedback received was not positive, the scope of the Commission Proposal was much more limited compared to the initial proposals. It especially did not consider any

longer the broad obligation requiring that, as part of their duty to act in the corporate interest, directors and supervisory directors must take into account the interest of all relevant stakeholders of the company. With the limitation established on the first initial proposal, the greater part of the Commission Proposal encompasses the provisions to introduce a mandatory due diligence obligation.

The mandatory due diligence proposal by the Commission is largely developed on OECD Guidelines. It is extensive since it covers undertakings that go beyond defined thresholds and are established or active in the EU, whether listed on the stock exchange or not. As stressed by BUSINESSEUROPE (2022) - advocate for growth and competitiveness at the European Level - : “European companies fully understand the importance of becoming more sustainable and of addressing risks that can occur in their supply chains. Companies recognize the advantages of a harmonized EU framework on due diligence, which also applies to third-country companies operating in the EU. However, key conditions must be met related to workability, proportionality, legal certainty, and level playing field.” The Commission Proposal is acknowledged for its effort to enact a more sustainable corporate scenario, but with due modifications to fit the companies’ purpose.

A political compromise - The Role of the Council in the Directive

The political Compromise is the document that results from negotiations within the Council that occurred between February and December 2022³. This outcome produced many changes compared to the Commission Proposal.

The document adopted the term “chain of activities” instead of “value chain” as it was the Commission’s choice. The term is more neutral and if approved in the final version of the directive will reduce substantially the scope of due diligence obligation envisaged by the commission.

The draft of the Council also differs from the Commission’s Proposal when it comes to civil liability, the application of the CSDDD for financial services companies and the applicability of the directive in companies of a certain size and turnover, at least in the first years of the law functioning.

However, I would like to highlight here the biggest modification made by the

³ Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 available at: <https://data.consilium.europa.eu/doc/document/ST-15024-2022-REV-1/en/pdf>

Council's political compromise, that it, the complete remotion of sustainable corporate governance articles from its document.

As perceived, the receptibility of the first initiative of the Commission's proposal regarding sustainable governance and directors' duties, expressed in articles 25 and 26 of its impact assessment was not positive. Nonetheless, it remains present in the EC proposal. The Council's justification for its deletion is underpinned by member states' pressure for its removal and the justification given by the RSB; some of the Union's member states already exert such obligation. For example, in the Netherlands or in Germany, the role of the board is entrenched with responsible business duties.

The drafting of Article 25, which through the use of directors' duty could help in the integration of sustainability values in businesses' decision-making has been criticized for its lack of clarity and vagueness. The wording of the article (that subtly resonates with Section 172 of the 2006 UK Company's Act) provides an open-ended list of additional aspects directors must consider but it is actually more generalist when it proposes "the best interest of the company", also, according to Agostini and Cogartelli⁴ it is as if the company is a separate entity on top of the directors' priorities. The European Company Law Experts Group (ECLE) has noted that this concept is not completely familiar to many EU jurisdictions, reinforcing the confusion it can be caused by the lack of precision.

With more negative than positive feedback received from its maintenance in the Commission's Proposal, after its due appreciation, the Council decided to drop it from its political compromise and it was not present either in the JURI Committee draft, passed later on in April 2023, with the adoption of a compromise text in response of the Commission's Proposal. The discussion regarding incorporating sustainability into corporate governance as a component of directors' responsibilities is not yet concluded, as the trilogue talks are yet to take place, this way, the CSDDD draft remains essentially with a due diligence core.

The origins of Due Diligence

Due diligence arises as mechanism of risk reduction for the corporate sector, thus it seeks the diminution of impacts in the economic management of corporations. Due diligence takes different purposes depending on the forms. In the case of due diligence on human rights, the mechanism of risk management that it seeks to mitigate are the damage that

⁴ Art. 25 of the proposed Due Diligence Directive: Quo Vadis? <https://blogs.law.ox.ac.uk/oblb/blog-post/2022/09/art-25-proposed-due-diligence-directive-quo-vadis> last accessed 20/11/2023.

corporate activity can provoke on human rights and in the environment.

This application started to be used in the 1980's with the rise of globalization, with the emergence of the global agenda for human rights and business, and with the growing influence of the OECD as a need for greater transparency in how companies were doing business. This transparency was to be achieved through the mapping of the production chain as companies started to outsource much of their manufacturing and supply chain operations. In this context, self-monitoring and CSR are the foundation of the institute, at this early stage, and compliance with them is directly related to the company's image.

Professor John G. Ruddle is the responsible for establishing a framework that popularized the concept of due diligence in business and human rights. The UNGP, or the United Nations Guiding Principles on Business and Human Rights were developed during his six years of mandate as The UN Secretary-General's Special Representative for Business and Human Rights. The framework, composed principles and recommendations that are part of the soft law instruments used to guide businesses on how to conduct their activities responsibly and envisage a process that must identify, prevent, mitigate, monitor and account for the risks and impacts of business activity.

Principles 16 to 24 are those most related to due diligence, as they seek to establish the self-monitoring mechanisms and commitments that companies must follow to prevent and mitigate their 'impacts'. Principle 17 makes explicit mention of the topic: "In order to identify, prevent, mitigate and repair the negative impacts of their activities on human rights, companies must carry out human rights due diligence. This process must include an assessment of the actual and potential impact of the activities on human rights, the integration of the findings and its action in this regard; monitoring responses and communicating how negative consequences are addressed. Human rights due diligence:

1. It must cover negative impacts on human rights that have been caused or contributed to by the company through its own activities, or that are directly related to its operations, products or services provided through its commercial relationships;
2. It will vary in complexity depending on the size of the company, the risk of serious negative consequences on human rights and the nature and context of its operations;

3. It must be a continuous process, bearing in mind that risks to human rights may change over time, depending on the evolution of operations and the operational context of companies.” (UN, 2011).

At the time, the reception of these guiding principles was acclaimed specially because of their voluntary character. Nowadays we see the opposite trend: Businesses and organizations welcome mandatory regulations because they come with the promise of a more uniform and equivalent enactment. If we look at the sustainable governance resolution adopted on 17 December 2020, a number of recommendations was made, specifically it was requested a legislative framework to be established including compulsory standards, so the information collected and disclosed would be clear, balanced, understandable, comparable among companies within the same sector, measurable, objective and include a time-bound sustainability target. (Resolution of 17 December 2020 on sustainable corporate governance, European Parliament).

Another evidence of the change in trend of perception between soft law and hard law can be seen in the survey⁵ made in regard of the new Corporate Sustainability Reporting Directive 2022/2464/EU (CSRD) that comes into force in 2024 in place of the NFRD 2014/95/EU (Non-Financial Reporting Directive) with many respondents in favor of simplified reporting framework standards including mandatory ones.

Mandatory Due Diligence on Human Rights in Europe

Currently in the European Union, some Member States have already adopted mandatory due diligence regulations in their national ordinary law regime. It is the case for example in France, with its *Loi Relative at devoir de vigilance* (2017) and in Germany with *Sorgfaltspflichtengesetz* (2021)⁶. Other Member States, as Belgium, the Netherlands, Luxembourg and Sweden are planning to introduce such a legislation soon.

As acknowledged by the European Parliament, mandatory corporate due diligence remains as a top priority, since more participation is demanded from more companies in the continent or with business' relationships established in the EU soil. In 2021, the Parliament recommended the necessary creation of a mandatory due diligence and accountability

⁵ https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Financial-Reporting-Directive/public-consultation_it

⁶ <https://www.bmz.de/de/aktuelles/archiv-aktuelle-meldungen/bundeskabinett-lieferkettengesetz-60076>.

directive⁷:

Considers that voluntary due diligence standards have limitations and have not achieved significant progress in preventing human rights and environmental harm and in enabling access to justice; considers that the Union should urgently adopt binding requirements for undertakings to identify, assess, prevent, cease, mitigate, monitor, communicate, account for, address and remediate potential and/or actual adverse impacts on human rights, the environment and good governance in their value chain; believes that this would be beneficial for stakeholders, as well as for businesses in terms of harmonization, legal certainty, a level playing field and mitigating unfair competitive advantages of third countries that result from lower protection standards as well as social and environmental dumping in international trade; stresses that this would enhance the reputation of Union undertakings and of the Union as a standard setter; stresses the proven benefits for undertakings of having effective responsible business conduct practices in place, which include better risk-management, a lower cost of capital, overall better financial performance, and enhanced competitiveness; is convinced that due diligence increases certainty and transparency as regards the supply practices of undertakings sourcing from countries outside the Union and will help protect consumer interests by ensuring the quality and reliability of products, and should lead to more responsible purchasing practices and long-term supplier relationships of undertaking [...]

A year later, in 2022 the Commission presented its directive proposal. The Proposed Directive presents an opportunity to refine and reshape their national regimes that are not completely in line with the regime set out in the directive. It remains to be seen whether national legislatures will opt to reform and modify existing schemes or establish new schemes based on the EU model⁸.

Final Considerations

The proposal for a Corporate Due Diligence Directive is the first of its kind to demand general corporate responsibility legislation at the European level. The proposal doesn't aim at replacing national level mechanisms of due diligence, as it is already existing in some Member States. The Proposed Directive presents an opportunity for achieving a more just, fair, and transparent chain of activities in which human and environmental rights are protected. It is also an opportunity to reach a larger scope of companies since it does not constrain itself in the European territory.

Following the proposed directive purposes, it infers that essential to ensure that the single market remains unified in terms of due diligence requirements, to create legal certainty for businesses and stakeholders in terms of expected behavior and liability.

⁷ Parliament Resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)) last accessed 25/11/2023 available at https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073_EN.html.

⁸ The Emergence of a European Duty of Vigilance for Large Companies and Its Potential Impact at the National Level | Latham & Watkins LLP – JDSupra available at <https://www.jdsupra.com/legalnews/the-emergence-of-a-european-duty-of-2516389> last accessed 23/11/2023.

Additionally, it is essential to increase corporate responsibility for any negative impacts, and to ensure consistency for companies in relation to obligations under current and proposed EU initiatives related to responsible business conduct.

The European Parliament is scheduled to recess in early spring of the following year for re-election, thus increasing the urgency of the process. If the Spanish Presidency is unable to secure a legislative vote before the end of the calendar year, the file will be transferred to the Belgian Presidency, thus exacerbating the urgency of the situation.

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