Questions and Answers: Proposal for a Directive on corporate sustainability due diligence

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Why is the Commission presenting this initiative?

The transformation to a sustainable economy is a key political priority of the EU. It is essential for the wellbeing of our society and our planet. Companies play a key role in creating a sustainable and fair economy and society but they need support in the form of a clear framework. EU-level legislation on corporate sustainability due diligence will advance the green transition, and protect human rights in Europe and beyond.

In addition to the European Parliament and Council, civil society as well as companies also call for action. Around 70% of companies participating in the 2020 preliminary Study on due diligence as well as the 2021 Open public consultation agreed that a harmonized EU legal framework on due diligence for human rights and environmental impacts is needed. Based on 2020 consumer survey, nearly eight in 10 respondents indicate that sustainability is important for them.

Why is voluntary action by companies not sufficient to address human rights and environmental impacts?

Many companies are already putting in place corporate sustainability tools. For instance, in the 2020 Study on due diligence requirements through the supply chain, a third of respondents from companies across all sectors, said that their companies undertake work in this area, taking into account all human rights and environmental impacts. Such own commitments or voluntary initiatives are laudable, and have helped tackle sustainability problems to a certain extent.

However, research shows that when companies take voluntary action, they focus on the first link in the supply chains while human rights and environmental harm occurs more often further down in the value chain. Furthermore, progress is slow and uneven.

This is why it is time to have clear rules in place.

What will companies be required to do?

The new proposal sets out a corporate due diligence duty to identify, prevent, bring to an end, mitigate and account for adverse human rights and environmental impacts in the company's own operations, its subsidiaries and their value chains. It builds on the UN's Guiding Principles on Business and Human Rights and OECD Guidelines for Multinational Enterprises and responsible business conduct, and is in line with internationally recognised human rights and labour standards.

In practice, the new proposal will require the companies within its scope to:

- Integrate due diligence into policies.
- Identify actual or potential adverse human rights and environmental impacts.
- Prevent or mitigate potential impacts.
- Bring to an end or minimise actual impacts.
- Establish and maintain a complaints procedure.
- Monitor the effectiveness of the due diligence policy and measures.
- Publicly communicate on due diligence.

In order to achieve a meaningful contribution to the sustainability transition, due diligence under this Directive should be carried out with respect to all adverse human rights and environmental impacts identified in its Annex.

This means that companies must take appropriate measures to prevent, end or mitigate impacts on the rights and prohibitions included in international human rights agreements, for example, regarding workers' access to adequate food, clothing, and water and sanitation in the workplace.

Companies are also required to take measures to prevent, end or mitigate negative environmental impacts that run contrary to a number of multilateral environmental conventions.

In addition, the new proposal requires certain large companies to adopt a plan to ensure that their business strategy is compatible with limiting global warming to 1.5 °C in line with the Paris Agreement.

What are directors obliged to do and how will their duties be enforced?

The Directive also introduces duties for the directors of the EU companies that it covers. These duties include setting up and overseeing the implementation of the due diligence processes and integrating due diligence into the corporate strategy. In addition, when directors act in the interest of the company, they must take into account the human rights, climate and environmental consequences of their decisions and the likely consequences of any decision in the long term. Companies have to duly take into account the fulfilment of the obligations regarding the corporate climate change plan when setting any variable remuneration linked to the contribution of a director to the company's business strategy and long-term interests and sustainability.

The rules on directors' duties are enforced through existing Member States' laws.

Will all companies be affected by these rules?

The new rules will only apply to large limited liability companies with substantial economic strength. Small and Medium Enterprises are excluded from the direct scope. This is about companies with 500+ employees and a net turnover over €150 million worldwide. 2 years after the new rules start applying, new rules will also be extended to other limited liability companies with 250+ employees and a net turnover over €40 million worldwide, in sectors where a high-risk of human rights violations or harm to the environment has been identified, e.g. in agriculture, textiles or minerals. The Directive will also apply to non-EU companies active in the EU with a turnover threshold aligned with the above, generated in the EU.

Will SMEs be affected by the new rules?

SMEs do not fall under the scope of the Directive. Nevertheless, they might be indirectly affected by the new rules as a result of the effect of large companies' actions across their value chains. Therefore, the proposal foresees specific support addressed to SMEs, such as guidance and other tools to help them gradually integrate sustainability considerations in their business operations. Member States shall provide further technical support, and may provide financial support to SMEs to facilitate adaptation. The proposal will also contain elements to protect SMEs from excessive requirements from large companies.

What happens if companies do not comply with the new rules?

Member States will supervise that companies comply with their due diligence obligations. Member States could impose fines to companies, or issue orders requiring the company to comply with the due diligence obligation.

It is particularly important to enable victims to obtain compensation for damage. Therefore, the proposal will also give those affected by harm the opportunity to hold companies to account. This means that victims will have the possibility to bring a civil liability claim before the competent national courts. Such civil liability concerns companies' own operations and its subsidiaries and established business relationships with which a company cooperates on a regular and frequent basis, where the harm could have been identified, and prevented or mitigated, with appropriate due diligence measures.

How will effective enforcement be ensured?

Member States will designate an authority to ensure effective enforcement. The Directive also requires Member States to adapt their rules on civil liability to cover cases where damage results from failure by a company to comply with due diligence obligations, building on their existing regimes on civil liability.

At European level, the Commission will set up a European Network of Supervisory Authorities that will bring together representatives of the national bodies, in order to ensure a coordinated approach and enable knowledge and experience sharing.

What are the benefits for citizens?

Citizens will become more aware of the impact of the products they buy and services they use. The main benefits will be the following:

- **More transparency and reliability** on how products are made and services delivered.

- **Protection of human rights** – sustainable business models have to prevent human rights abuses.
- **Healthier environment** and a longer-term commitment to the environment from companies. Citizens could also feel more motivated to protect the environment, knowing that they are not alone in their efforts and companies are doing their share as well.

What are the benefits for companies?

For the first time ever, companies operating in the EU market will have common and clear rules on corporate sustainability due diligence. The main benefits will be the following:

- **Preventing legal fragmentation**. Some EU countries have developed national rules (such as France, Germany or the Netherlands) or want to do so (e.g. Austria, Belgium, Finland, Denmark) but the scope of these measures varies a lot from one country to the other. Moreover, there are many voluntary initiatives in place. This causes legal uncertainty for companies across the EU.
- **Meeting consumers' expectations.** Consumers are drawn increasingly to products made in an ethically and environmentally sustainable way, for example, without using harmful substances. They also perceive greater benefit and value from products sold by a socially responsible company, like ethical cocoa.
- **Meeting investor expectations.** Investors prompt transparency requirements. Without mandatory action, investors and consumers would miss consistent benchmarks to be assured about the value chain standards.
- **Reinforcing risk management.** Thanks to the new rules, companies will have a clearer view of their operations and supply chain, including higher awareness of their negative impacts, and will be able to detect problems and risks (including reputational risks) early.
- **Generating economic benefits.** Research shows that companies which incorporate sustainability factors into their policy generate higher returns.
- **Increasing resilience.** Researchers found that companies which had integrated social, environmental and health considerations into their strategies weathered the COVID-19 crisis better and saw a milder drop in stock prices during the pandemic than those who had not.

What are the costs for companies?

The new rules on due diligence will apply to companies of significant size and economic strength and those operating in high impact sectors such as textiles, agriculture, extraction of minerals. While SMEs are not subject to direct obligations in the proposal, accompanying measures will support SMEs that may be indirectly affected.

In order to comply with the new rules, companies may incur costs related to establishing and operating due diligence processes and procedures. In addition, companies may also incur additional transition costs from investments needed to change their own operations and value chains to address adverse impacts.

How will this proposal ensure EU companies remain competitive?

Companies' competitiveness increasingly relies on their ability to ensure sustainable practices all along their value chains. Consumers are more and more aware of the choices they make with their purchases, raising demands for sustainable and responsibly sourced products and services. At the same time, investors are also increasingly considering businesses' sustainability when looking for new investment opportunities. The varying existing and planned national due diligence rules as well as numerous voluntary initiatives cause legal uncertainty for companies across the EU, fragmentation of the Single market, additional costs and complexity. The proposal therefore aims to provide a harmonised, clear and coherent framework. It will also potentially become a model worldwide on sustainable value chains.

By helping companies better address the impacts in their value chains, the proposal will not only improve companies' competitiveness, but also their efficiency and financial performance, preparedness and long-term resilience.

What is the impact of the new rules on developing countries?

The new rules will bring multiple benefits for developing countries, including a better protection of human rights and the environment, better adoption of international standards and facilitation of better access to remedies for victims of harmful corporate practices.

The proposal should achieve the most significant positive impacts in the EU's main trading partners in developing countries. The Commission looks forward to working further with EU trading partners to ensure mutually reinforcing initiatives, including development of voluntary sustainability standards, support of multi-stakeholder alliances and industry coalitions, as well as accompanying support provided through EU development policy and other international cooperation instruments.

The proposal also aims to address potential negative effects on trading partners in developing countries, which could include companies withdrawing from very risky territories if they cannot mitigate harm due to systemic issues. In this regard, the proposal contains accompanying measures, such as capacity-building support for SMEs with a view to mitigating such possible impacts. The aim is to make clear that companies should prioritise engagement with business relationships in the value chain, instead of disengaging, which should stay a last resort.

Are there international standards on corporate sustainability due diligence?

2011 United Nations Guiding Principles on Business and Human Rights state that companies should avoid infringing the human rights of others and should address adverse human rights impacts with which they are involved in their own operations and through their direct and indirect business relationships. The OECD Guidelines for Multinational Enterprises, related Guidance on Responsible Business Conduct and sectoral guidance specify and further develop this concept of due diligence. The recommendations of the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy also embed this concept. The OECD framework extended the application of due diligence to cover environmental harm.

What are examples of mitigating measures?

The Commission has conducted a comprehensive mapping of existing EU-funded actions whose objectives and results are accompanying the implementation of the Directive. The mapping identified about 75 relevant ongoing Commission actions. An example of such action is the garment traceability project with UNECE and ITC. This project provides tools for companies that are immediately relevant for their due diligence obligations.

For More Information

Press release

Proposal for a Directive on corporate sustainability due diligence + Annex

Factsheet on corporate sustainability due diligence

Webpage on corporate sustainability due diligence

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