

RocaJunyent Informs

ESG Department: Corporate Sustainability

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Proposal for a Directive of the European Parliament and of the Council on sustainability due diligence for companies and amending Directive (EU) 2019/1937

On **1 June 2023**, the European Parliament approved the amendments tabled to the European Commission's proposal for a Corporate Sustainability Due Diligence Directive of February 2022, setting out its position in the process of adopting the European standard.

The initiative is in line with the **EU Action Plan for Human Rights and Democracy 2020-2024**, which includes a commitment by the EU and Member States to strengthen their engagement to actively promote the implementation of international standards for responsible business conduct, such as the UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises and the OECD/ECD Due Diligence Guidance.

1. Aim

The proposal for a **Directive on corporate sustainability due diligence** aims to promote sustainable and responsible business behaviour among companies.

To this end, a set of standards is established on the obligations of companies in relation to the actual and potential adverse effects on human rights and the environment derived from their own activities, their subsidiaries' activities and the value chain activities of entities with which they have an established business relationship, as well as on the liability arising from non-compliance with these standards.

In particular, the proposed Directive sets the following targets:

- 1) **To improve corporate governance practices** to better integrate risk management and mitigation processes for human rights and environmental risks and impacts, including those arising from value chains, into business strategies.
- 2) **To avoid fragmentation of due diligence requirements in the single market** and to create legal certainty for companies and stakeholders as regards expected behaviour and accountability.
- 3) **To increase corporate liability for adverse effects** and ensure consistency for companies with regard to obligations.
- 4) **To improve access to remedy for those affected** by adverse human rights and environmental impacts of corporate behaviour.
- 5) **To complement other existing or proposed measures** that directly address some specific sustainability challenges or that apply in some specific sectors, mainly within the Union, such as the Sustainable Finance Disclosure Regulation, the Taxonomy Regulation or the "Fit for 55" package.

2. Scope of application

The criteria for its application are based on the number of employees and the world-wide net turnover of EU companies, as well as on the net turnover generated in the common territory in the case of non-EU companies.

In contrast to the European Commission's proposal, the amendments proposed by the European Parliament modify the scope of application of the directive, lowering the thresholds, as the new obligations are set to apply to:

- ☐ **EU companies with more than 250 employees and a worldwide net turnover of more than EUR 40 million** and, in the case of companies below these thresholds, being the ultimate parent company of a group with 500 employees and a worldwide net turnover of more than EUR 150 million.
- ☐ For **non-European companies, it is foreseen to include those with a turnover exceeding EUR 150 million, with at least EUR 40 million generated in the European Union.**

3. Obligations

Member States shall ensure that obliged undertakings integrate due diligence into all their policies and that they implement a **due diligence policy**. The due diligence policy shall meet the following objectives:

- 1) To **identify** actual and potential negative effects on human rights and the environment.
- 2) To **prevent** potential adverse effects on human rights and the environment.
- 3) To **take** the necessary measures to terminate or minimise the negative effects caused.
- 4) To **ensure** and maintain a complaint procedure for victims, trade unions and civil society organisations.
- 5) To periodically **assess** the effectiveness of the measures in place and, where appropriate, to update the due diligence policy in the light of the assessment made.
- 6) To **publish** annually on their website a statement reporting on the due diligence process carried out, the actual and potential negative effects, and the actions taken.

Member States shall ensure that companies take **appropriate measures to prevent** or, where prevention is not possible or not immediately possible or has failed, sufficiently **mitigate potential adverse human rights and environmental impacts** that have been or should have been identified.

In this regard, companies will be required to **take appropriate measures**, including the following, where appropriate:

- ☐ Where the nature or complexity of the necessary preventive measures so requires, developing **and implementing a preventive action plan**, with a reasonable and clearly defined timeframe for the implementation of appropriate measures and actions and qualitative and quantitative indicators to measure improvements. The preventive action plan shall be applicable and precisely tailored to the context of the companies' operations and value chain.

- ☐ Considering establishing contractual arrangements with business partners to ensure their compliance with the company's code of conduct and, where applicable, the preventive action plan. Partners with whom the company has a business relationship could be asked to establish reasonable, non-discriminatory and fair contractual arrangements with their own partners, to the extent that their activities are part of the companies' value chain.
- ☐ Making necessary modifications, improvements, deletions or investments in the company's own activities, e.g. in management, production or other operational processes, facilities, products and traceability of products, projects, services and capacities;
 - ✎ Adapting business models and strategies, including purchasing practices, including those that contribute to living wages and incomes for their suppliers, to avoid potential adverse effects, and developing and using purchasing policies that do not encourage potential adverse effects on human rights or the environment.
- ☐ Providing specific and proportionate financial and administrative support to SMEs with which the company has a business relationship;
 - ✎ Building a business relationship on the company's expectations regarding the prevention and mitigation of potential adverse effects, in particular by providing or enabling access to capacity building, guidance, administrative and financial support, such as loans or financing, taking into account the resources, expertise and constraints of the business partner;
- ☐ Collaborating with other entities with the aim, inter alia, of increasing the company's ability to eliminate adverse effects, especially when no other action is adequate or effective.

Contractual provisions shall be accompanied by measures to facilitate the conduct of due diligence. Where provisions, including contractual provisions, are laid down or a contract is concluded with a business relationship, the terms used shall be fair, reasonable and non-discriminatory. In addition, where compliance verification measures are applied in relation to SMEs, the company shall bear the cost of verification by independent third parties.

Where potential adverse impacts that a company has caused or contributed to cannot be adequately prevented or mitigated, and where there is no reasonable prospect of change, the company shall be required to refrain from entering into new or extending existing relationships with the partner in relation to whose value chain or in whose value chain such impacts have arisen and, where the law governing its relationships so permits, shall take the following measures, as a last resort, in line with responsible disengagement:

- ☐ Temporarily suspending trade relations with the partner concerned while prevention and mitigation measures are implemented,
- ☐ Terminating the business relationship with respect to the activities in question because of the seriousness of the potential adverse effects or if the conditions for temporary suspension are not met.

On the other hand, as part of the transparency obligations, provision is made for the supervisory authorities to publish and regularly update the list of companies subject to the directive under their jurisdiction, with links to access, where appropriate, the companies' due diligence declarations.

As regards **managers**, they will be responsible for monitoring the obligation to establish a plan to ensure that their business model and strategy are compatible with the transition to a sustainable economy and with limiting global warming to 1.5°C in line with the Paris Agreement, as well as the other obligations.

Finally, financial, criminal and civil liability **sanctions** are foreseen. The criteria for the imposition of penalties will take into account the company's efforts to implement corrective measures, investments made, collaboration with other entities to address the adverse effects, the severity and duration of the adverse effects that have occurred, penalties imposed in other Member States, etc. In any case, the **ceiling for financial penalties shall not be less than 5% of the company's worldwide net turnover**.

4. Entry into force

Following the approval, on 1 June 2023, of the amendments presented by the European Parliament to the European Commission's proposal for a Directive, the legislative procedure for its definitive approval now continues with the informal tripartite dialogue, where the different points of view are debated in search of consensus, and compromises are obtained to ensure the effectiveness of the legislative process and which will culminate in the adoption of a definitive text by the Parliament and the Council. Once the Directive has been approved, which is expected to happen in 2023, the two-year transposition period will begin and companies will have three to four years to apply the new rules, depending on their size and turnover.