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2022/0051 (COD)

Proposal for a

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937**

(Text with EEA relevance)

{SEC(2022) 95 final} - {SWD(2022) 38 final} - {SWD(2022) 39 final} -  
{SWD(2022) 42 final} - {SWD(2022) 43 final}

## EXPLANATORY MEMORANDUM

### 1. CONTEXT OF THE PROPOSAL

#### Reasons for and objectives of the proposal

The behaviour of companies across all sectors of the economy is key to succeed in the Union's transition to a climate-neutral and green economy<sup>1</sup> in line with the European Green Deal<sup>2</sup> and in delivering on the UN Sustainable Development Goals, including on its human rights- and environment-related objectives. This requires implementing comprehensive mitigation processes for adverse human rights and environmental impacts in their value chains, integrating sustainability into corporate governance and management systems, and framing business decisions in terms of human rights, climate and environmental impact, as well as in terms of the company's resilience in the longer term.

EU companies operate in complex surroundings and, especially large ones, rely on global value chains. Given the significant number of their suppliers in the Union and in third countries and the overall complexity of value chains, EU companies, including the large ones, may encounter difficulties to identify and mitigate risks in their value chains linked to respect of human rights or environmental impacts. Identifying these adverse impacts in value chains will become easier if more companies exercise due diligence and thus more data is available on human rights and environmental adverse impacts.

The connection of the EU economy to millions of workers around the world through global value chains comes with a responsibility to address adverse impacts on the rights of these workers. A clear request by Union citizens, in particular in the framework of the Conference on the Future of Europe, for the EU economy to contribute to address these and other adverse impacts is reflected in the existing or upcoming national legislation on human rights and environmental due diligence<sup>3</sup>, in the debates ongoing at national level and in the call for action from the European Parliament and the Council. Both of these institutions have called on the Commission to propose Union rules for a cross-sector corporate due diligence obligation.<sup>4</sup> In their Joint Declaration on EU Legislative Priorities for 2022<sup>5</sup>, the European Parliament, the Council of the European Union and the European Commission have

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<sup>1</sup> Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law'), which also includes a binding target to cut domestic net greenhouse gas emissions by at least 55% compared to 1990 levels by 2030.

<sup>2</sup> Communication from the Commission on the European Green Deal, COM/2019/640 final.

<sup>3</sup> So far France (*Loi relative au devoir de vigilance, 2017*) and Germany (*Sorgfaltspflichtengesetz, 2021*) have introduced a horizontal due diligence law, other Member States (Belgium, the Netherlands, Luxembourg and Sweden) are planning to do so in the near future, and the Netherlands has introduced a more targeted law on child labour (*Wet zorgplicht kinderarbeidm 2019*).

<sup>4</sup> European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)); Council Conclusions on Human Rights and Decent Work in Global Supply Chains of 1 December 2020 (13512/20).

<sup>5</sup> Joint declaration of the European Parliament, the Council of the European Union and the European Commission on EU Legislative Priorities for 2022 (OJ C 514I, 21.12.2021, p. 1).

committed to deliver on an economy that works for people, including to improve the regulatory framework on sustainable corporate governance.

Using the existing international voluntary standards on responsible business conduct,<sup>6</sup> an increasing number of EU companies are using value chain due diligence as a tool to identify risks in their value chain and build resilience to sudden changes in the value chains, but companies may also face difficulties when considering to use the value chain due diligence for their activities. Such difficulties can be for instance due to lack of legal clarity regarding corporate due diligence obligations, complexity of value chains, market pressure, information deficiencies, and costs. As a consequence, the benefits of due diligence are not widespread among European companies and across economic sectors.

Mostly large companies have been increasingly deploying due diligence processes as it can provide them with a competitive advantage.<sup>7</sup> This also responds to the increasing market pressure on companies to act sustainably as it helps them avoid unwanted reputational risks vis-à-vis consumers and investors that are becoming increasingly aware of sustainability aspects. However, these processes are based on voluntary standards and do not result in legal certainty for neither companies nor victims in case harm occurs.

Voluntary action does not appear to have resulted in large scale improvement across sectors and, as a consequence, negative externalities from EU production and consumption are being observed both inside and outside the Union. Certain EU companies have been associated with adverse human rights and environmental impacts, including in their value chains.<sup>8</sup> Adverse impacts include, in particular, human rights issues such as forced labour, child labour, inadequate workplace health and safety, exploitation of workers, and environmental impacts such as greenhouse gas emissions, pollution, or biodiversity loss and ecosystem degradation.

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<sup>6</sup> United Nations' "Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework" (2011), available at [https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR\\_EN.pdf](https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf).

OECD Guidelines for Multinational Enterprises (2011 update), available at: <https://doi.org/10.1787/9789264115415-en>, with set of recommendations on responsible business conduct, as well as specific OECD Due Diligence Guidance for Responsible Business Conduct (2018) and OECD sectoral guidance, available at: <https://mneguidelines.oecd.org/mneguidelines/>.

<sup>7</sup> See Impact Assessment accompanying this proposal, p. 15, 23.

<sup>8</sup> The Study on due diligence, European Commission, Directorate-General for Justice and Consumers, Smit, L., Bright, C., et al., Study on due diligence requirements through the supply chain: final report, Publications Office, 2020, <https://data.europa.eu/doi/10.2838/39830>, p. 221, indicates that corporate risk assessment processes continue to focus on the materiality of the risks to the company, despite international guidance (UNGPs, OECD) which clarifies that the relevant risks for due diligence must extend beyond the risks of the company to those who are affected (the rights-holders). Negative corporate impacts as a consequence of globalisation and failure to undertake due diligence, ranging from environmental disasters (see at <https://www.business-humanrights.org/en/blog/brumadinho-dam-collapse-lessons-in-corporate-due-diligence-and-remedy-for-harm-done/>) and land grabbing (see at [https://www.europarl.europa.eu/RegData/etudes/STUD/2016/578007/EXPO\\_STU\(2016\)578007\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2016/578007/EXPO_STU(2016)578007_EN.pdf)) to serious violations of labour and human rights, (see at [https://www.europarl.europa.eu/RegData/etudes/BRIE/2014/538222/EPRS\\_BRI\(2014\)538222\\_REV1\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2014/538222/EPRS_BRI(2014)538222_REV1_EN.pdf)) are well documented.

In the last years, emerging legal frameworks on corporate due diligence in Member States<sup>9</sup> reflect the increasing desire to support companies in their endeavour to perform due diligence in their value chains and foster business conduct that respects human rights, children's rights and the environment. On the other hand, they also bring fragmentation and risk undermining legal certainty and a level playing field for companies in the single market.

Union legislation on corporate due diligence would advance respect for human rights and environmental protection, create a level playing field for companies within the Union and avoid fragmentation resulting from Member States acting on their own. It would also include third-country companies operating in the Union market, based on a similar turnover criterion.

Against this background, this Directive will set out a horizontal framework to foster the contribution of businesses operating in the single market to the respect of the human rights and environment in their own operations and through their value chains, by identifying, preventing, mitigating and accounting for their adverse human rights, and environmental impacts, and having adequate governance, management systems and measures in place to this end.

In particular, this Directive will:

- (1) improve corporate governance practices to better integrate risk management and mitigation processes of human rights and environmental risks and impacts, including those stemming from value chains, into corporate strategies;
- (2) avoid fragmentation of due diligence requirements in the single market and create legal certainty for businesses and stakeholders as regards expected behaviour and liability;
- (3) increase corporate accountability for adverse impacts, and ensure coherence for companies regarding obligations under existing and proposed EU initiatives on responsible business conduct;
- (4) improve access to remedies for those affected by adverse human rights and environmental impacts of corporate behaviour;
- (5) being a horizontal instrument focussing on business processes, applying also to the value chain, this Directive will complement other measures in force or proposed, which directly address some specific sustainability challenges or apply in some specific sectors, mostly within the Union.

### **Consistency with existing policy provisions in the policy area**

At EU level, sustainable corporate governance has been mainly fostered indirectly by imposing reporting requirements in the [Non-Financial Reporting Directive \(NFRD\)](#)<sup>10</sup> on

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<sup>9</sup> See footnote 3.

<sup>10</sup> Directive 2014/95/EU amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (OJ L 330, 15.11.2014, p. 1–9). The NFRD is therefore an amendment of the Accounting Directive, i.e. of Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ L 182, 29.6.2013).

approximately 12 000 companies<sup>11</sup> concerning environmental, social and human rights related risks, impacts, measures (including due diligence) and policies.<sup>12</sup> The NFRD had some positive impact on improvement of responsible business operation, but has not resulted in the majority of companies taking sufficient account of their adverse impacts in their value chains.<sup>13</sup>

The Commission's recent [proposal for a Corporate Sustainability Reporting Directive \(CSRD\), revising the NFRD](#)<sup>14</sup>, would extend the scope of the companies covered to all large and all listed companies<sup>15</sup>, require the audit (assurance) of reported information and strengthen the standardisation of reported information by empowering the Commission to adopt sustainability reporting standards.<sup>16</sup> This Directive will complement the current NFRD and its proposed amendments (proposal for CSRD) by adding a substantive corporate duty for some companies to perform due diligence to identify, prevent, mitigate and account for external harm resulting from adverse human rights and environmental impacts in the company's own operations, its subsidiaries and in the value chain. Of particular relevance of the proposal on CSRD is that it mandates disclosure of plans of an undertaking to ensure that its business model and strategy 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 two initiatives are closely interrelated and will lead to synergies. First, a proper information collection for reporting purposes under the proposed CSRD requires setting up processes, which is closely related to identifying adverse impacts in accordance with the due diligence duty set up by this Directive. Second, the CSRD will cover the last step of the due diligence duty, namely the reporting stage, for companies that are also covered by the CSRD. Third, this Directive will set obligations for companies to have in place the plan ensuring that the business model and strategy 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 on which the

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<sup>11</sup> Large public-interest entities that have more than 500 employees (and the balance sheet total or net turnover of which exceeds the Accounting Directive's threshold for large enterprises), including listed companies, banks and insurance companies. See CEPS' Study on the Non-Financial Reporting Directive, prepared for the European Commission to support the review of the NFRD, November 2020, available at <https://op.europa.eu/en/publication-detail/-/publication/1ef8fe0e-98e1-11eb-b85c-01aa75ed71a1/language-en>.

<sup>12</sup> See also some provisions of SRD II, i.e. Directive (EU) 2017/828 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (OJ L 132, 20.5.2017, p. 1–25).

<sup>13</sup> The Impact Assessment accompanying the Commission's proposal for the Corporate Sustainability Reporting Directive (SWD/2021/150 final) and the CEPS' Study on the Non-Financial Reporting Directive (section 2) found a limited change in corporate policies as a result of the NFRD, consistent with the perception of main stakeholders who could not identify a clear pattern of change in corporate behaviour driven by these reporting rules.

<sup>14</sup> Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting (COM/2021/189 final).

<sup>15</sup> The sustainability reporting obligation would apply to all large companies as defined by the Accounting Directive (which the CSRD would amend) and, as of 2026, to companies (including non-EU companies but excluding all micro enterprises) listed on EU regulated markets.

<sup>16</sup> The elaboration of draft sustainability reporting standards started in parallel with the legislative process in a project task force established by the European Financial Reporting Advisory Group (EFRAG) at the request of the Commission.

CSRD requires to report. Thus, this Directive will lead to companies' reporting being more complete and effective. Therefore, complementarity will increase effectiveness of both measures and drive corporate behavioural change for those companies.

This Directive will also underpin the [Sustainable Finance Disclosure Regulation](#)<sup>17</sup> (SFDR) that has recently entered into force and applies to financial market participants (such as investment fund and portfolio managers, insurance undertakings selling insurance-based investment products and undertakings providing various pension products) and financial advisers. Under the SFDR, these undertakings are required to publish, among others, a statement on their due diligence policies with respect to principal adverse impacts of their investment decisions on sustainability factors on a comply or explain basis. At the same time, for companies with more than 500 employees the publication of such a statement is mandatory, and the Commission is empowered to adopt regulatory technical standards on the sustainability indicators in relation to the various types of adverse impacts.<sup>18</sup>

Similarly, this Directive will complement the recent [Taxonomy Regulation](#)<sup>19</sup>, a transparency tool that facilitates decisions on investment and helps tackle greenwashing by providing a categorisation of environmentally sustainable investments in economic activities that also meet a minimum social safeguard.<sup>20</sup> The reporting covers also minimum safeguards established in Article 18 of the Taxonomy Regulation that refer to procedures companies should implement to ensure the alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organization on Fundamental Principles and Rights at Work and the International Bill of Human Rights when carrying out an economic activity categorized as “sustainable”. Like NFRD and the proposal for CSRD, the Taxonomy Regulation does not impose substantive duties on companies other than public reporting requirements, and investors can use such information when allocating capital to companies. By requiring companies to identify their adverse risks in all their operations and value chains, this Directive may help in providing more detailed information to the investors. It therefore complements the Taxonomy Regulation as it has the potential to further help investors to allocate capital to responsible and sustainable companies. Moreover, the Taxonomy Regulation (as providing a common language for sustainable economic activities for investment purposes) can serve as a guiding tool for companies to attract sustainable financing for their corrective action plans and roadmaps.

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<sup>17</sup> Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1–16).

<sup>18</sup> The three European Supervisory Authorities published on 4 February 2021 their Final Report (available at <https://www.esma.europa.eu/press-news/esma-news/three-european-supervisory-authorities-publish-final-report-and-draft-rtts>) to the Commission, including the draft regulatory technical standards on disclosures under the SFDR.

<sup>19</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (OJ L 198, 22.6.2020, p. 13–43).

<sup>20</sup> The Taxonomy will be developed gradually. Minimum social safeguards apply to all Taxonomy-eligible investments.

This Directive will complement [Directive 2011/36/EU on preventing and combating trafficking in human beings and protecting its victims](#)<sup>21</sup>, which constitutes a comprehensive legal framework to effectively fight all forms of exploitation in the Union by natural and legal persons, in particular forced labour, sexual exploitation, as well as begging, slavery or practices similar to slavery, servitude, or the exploitation of criminal activities, or the removal of organs. It also establishes the liability of legal persons for the offences referred to in that Directive committed for their benefit by any person who has a leading position within the legal person or the commission of the offence was possible due to the lack of supervision or control. Directive 2011/36/EU also provides for sanctions on the legal person held liable.

Furthermore, this Directive will complement the [Employers' Sanctions Directive](#)<sup>22</sup>, which prohibits the employment of irregularly staying third-country nationals, including victims of trafficking in human beings. The Employers' Sanctions Directive lays down minimum standards on sanctions and other measures to be applied in the Member States against employers who infringe upon the Directive.

This Directive will also complement existing or planned sectoral and product-related value chain due diligence instruments at EU level due to its cross-sectoral scope and broad range of sustainability impacts covered:

The so-called [Conflict Minerals Regulation](#)<sup>23</sup> applies to four specific minerals and metals. It requires EU companies in the supply chain to ensure they import tin, tungsten, tantalum and gold from responsible and conflict-free sources only and put in place more specific mechanisms for conducting due diligence, e.g. an independent third-party audit of supply chain due diligence. The due diligence provisions of this Directive address also environmental adverse impacts and will apply to value chains of additional minerals that are not covered in the Conflict Minerals Regulation but produce human rights, climate and environmental adverse impacts.

The Commission's [proposal for a Regulation on deforestation-free supply chains](#)<sup>24</sup> focuses on certain commodities and product supply chains. It has a very specific objective, namely to reduce the impact of EU consumption and production on deforestation and forest degradation worldwide. Its requirements will, in some areas, be more prescriptive compared to the general due diligence duties under this Directive. It also includes a prohibition of placing on the market certain commodities and derived products if the requirement of "legal" and

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<sup>21</sup> Directive 2011/36/EU of the European Parliament and of the Council of 5 April 2011 on preventing and combating trafficking in human beings and protecting its victims, and replacing Council Framework Decision 2002/629/JHA (OJ L 101, 15 April 2011, p.1).

<sup>22</sup> Directive 2009/52/EC of the European Parliament and of the Council of 18 June 2009 providing for minimum standards on sanctions and measures against employers of illegally staying third-country nationals (OJ L 168, 30. June 2009).

<sup>23</sup> Regulation (EU) 2017/821 of the European Parliament and of the Council of 17 May 2017 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas (OJ L 130, 19.5.2017, p. 1–20).

<sup>24</sup> Proposal for a Regulation of the European Parliament and of the Council on the making available on the Union market as well as export from the Union of certain commodities and products associated with deforestation and forest degradation and repealing Regulation (EU) No 995/2010 (COM(2021) 706 final).

“deforestation free” cannot be ascertained through due diligence. This prohibition will apply to all operators placing the relevant products on the Union market, including EU and non-EU companies, irrespective of their legal form and size. Therefore, while the overall objectives of the two initiatives are mutually supportive, their specific objectives are different. This Directive will complement the Regulation on deforestation-free products by introducing a value chain due diligence related to activities that are not covered by the Regulation on deforestation-free products but might be directly or indirectly leading to deforestation.

The Commission’s [proposal for a new Batteries Regulation](#)<sup>25</sup> has the specific objectives of reducing environmental, climate and social impacts throughout all stages of the battery life cycle, strengthening the functioning of the internal market, and ensuring a level playing field through a common set of rules. It requires economic operators placing industrial or electric vehicle batteries (including incorporated in vehicles) larger than 2 kWh on the Union market to establish supply chain due diligence policies. It focusses on those raw materials of which a significant amount of the global production goes into battery manufacturing and that may pose social or environmental adverse impacts (cobalt, natural graphite, lithium, and nickel). The economic operators must submit compliance documentation for third-party verification by notified bodies and are subject to checks by the national market surveillance authorities. This Directive will complement the Batteries Regulation by introducing a value chain due diligence related to raw materials that are not covered in that Regulation but without requiring certification for placing the products on the EU market.

The future [Sustainable Products Initiative \(SPI\)](#) aims to revise the current [Ecodesign Directive](#)<sup>26</sup> and concerns more broadly the sustainability of products placed on the EU market and the transparency of related information.

This proposal will play an essential role in tackling the use of forced labour the global value chains. As announced in the Communication on decent work worldwide<sup>27</sup> the Commission is preparing a new legislative proposal that will effectively prohibit the placing on the Union market of products made by forced labour, including forced child labour. The new initiative will cover both domestic and imported products and combine a ban with a robust, risk-based enforcement framework. The new instrument will build on international standards and complement horizontal and sectoral initiatives, in particular the due diligence obligations as laid down in this proposal.

This Directive is without prejudice to the application of other requirements in the areas of human rights, protection of the environment and climate change under other Union legislative acts. If the provisions of this Directive conflict with a provision of another Union legislative act pursuing the same objectives and providing for more extensive or more specific

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<sup>25</sup> Proposal for a Regulation of the European Parliament and of the Council concerning batteries and waste batteries, repealing Directive 2006/66/EC and amending Regulation (EU) No 2019/1020 (COM/2020/798 final).

<sup>26</sup> Directive 2009/125/EC of the European Parliament and of the Council of 21 October 2009 establishing a framework for the setting of ecodesign requirements for energy-related products (OJ L 285, 31.10.2009, p. 10).

<sup>27</sup> Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on decent work worldwide for a global just transition and a sustainable recovery, COM(2022) 66 final.



obligations, the provisions of the other Union legislative act should prevail to the extent of the conflict and should apply to those specific obligations

### **Consistency with other Union policies**

This Directive is important to fulfil objectives of various existing and planned Union measures in the field of the human rights, including labour rights, and environment.

As part of the European Green Deal, the Commission has listed an initiative on sustainable corporate governance among the deliverables of the [Action Plan on a Circular Economy](#), the [Biodiversity strategy](#), the [Farm to Fork strategy](#), the [Chemicals strategy, Updating the 2020 New Industrial Strategy: Building a stronger Single Market for Europe's recovery](#), and the [Strategy for Financing the Transition to a Sustainable Economy](#).

EU environmental law introduces various environmental requirements for companies, Member States, or defines goals for the Union<sup>28</sup>. However, it generally does not apply to value chains outside the Union where up to 80-90% of the environmental harm of EU production may occur<sup>29</sup>. The [Environmental Liability Directive](#)<sup>30</sup> establishes a framework for environmental liability with regard to prevention and remedying environmental damage based on the “polluter pays” principle for companies’ own operations. It does not cover companies’ value chains. The civil liability related to adverse environmental impacts of this Directive will be complementary to the Environmental Liability Directive.

This Directive will complement EU climate legislation, including the European Climate Law, setting in stone the Union’s climate ambition, with the intermediate target of reducing net greenhouse gas emissions by at least 55% by 2030, to set Europe on a responsible path to becoming climate-neutral by 2050. Most specifically, this Directive will complement the [“Fit for 55” Package](#)<sup>31</sup> and its various key actions, such as setting more ambitious energy efficiency and renewable energy targets for Member States by 2030 or the upgrading of the [EU Emissions Trading System](#)<sup>32</sup>, which needs to be underpinned by a wider transformation of production processes to achieve climate neutrality by 2050 across the economy and throughout value chains. The “Fit for 55” Package will only indirectly apply to some non-EU

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<sup>28</sup> For example it introduces limitations on the release of some pollutants, defines EU goals (such as the European Climate Law) or sets targets for Member States (such as for energy efficiency), defines obligations for Member States (e.g. on protection of natural habitats), establishes minimum content in authorisation procedures for some economic activities (e.g. Environmental Impact Assessment), etc.

<sup>29</sup> See e.g. Jungmichel, Norbert, Christina Schampel and Daniel Weiss (2017): Atlas on Environmental Impacts - Supply Chains – Environmental Impacts and Hot Spots in the Supply Chain, Adephi/Systain, available at <https://www.adelphi.de/en/system/files/mediathek/bilder/Umweltatlas%20Lieferkette%20-%20adelphi-Systain-englisch.pdf>.

<sup>30</sup> Directive 2004/35/CE of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage (OJ L 143, 30.4.2004, p. 56–75).

<sup>31</sup> The “Fit for 55” Package is a series of proposals adopted by the Commission on 14 July 2021 aiming to make the EU’s climate, energy, land use, transport and taxation policies fit for reducing net greenhouse gas emissions by at least 55% by 2030, compared to 1990 levels.

<sup>32</sup> Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and Regulation (EU) 2015/757 (COM/2021/551 final).

value chains of EU companies through the [Carbon Border Adjustment Mechanism \(CBAM\)](#)<sup>33</sup> which aims at preventing “carbon leakage”<sup>34</sup> by imposing a carbon adjustment price for selected imported products not subject to the carbon price deriving from the EU Emission Trading System.

Existing [EU health and safety, and fundamental rights legislation](#) targets very specific adverse impacts (such as violations of the right to privacy and data protection, discrimination, specific health aspects related to dangerous substances, threats to health and safety of workers, violations of rights of the child, etc.) within the Union<sup>35</sup> but does not apply in all cases to companies’ value chains outside the Union.

The initiative is in line with the [EU Action Plan on Human Rights and Democracy 2020-2024](#)<sup>36</sup>, which includes a commitment for the Union and Member States to strengthen their engagement to actively promote the implementation of international standards on responsible business conduct such as the UN Guiding Principles on Business and Human Rights and the OECD Guidelines on Multinational Enterprises and Due Diligence. It is consistent with the [EU Strategy on the Rights of the Child](#)<sup>37</sup> which commits the Union to a zero tolerance approach against child labour and to ensure that supply chains of EU companies are free of child labour. In the [EU Strategy on Combatting Trafficking in Human Beings 2021- 2025](#)<sup>38</sup> the Commission committed to put forward a legislative proposal on sustainable corporate governance to foster long-term sustainable and responsible corporate behaviour. The initiative also contributes to the goals of the Commission’s Communication on decent work worldwide<sup>39</sup>, which is adopted together with this proposal.

This Directive will contribute to the European Pillar of Social Rights as both promote rights such as fair working conditions<sup>40</sup>. It will – beyond its external angle – deal with the violation of international labour standards when they occur in the Union (e.g. forced labour cases in

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<sup>33</sup> Proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism (COM(2021) 564 final).

<sup>34</sup> “Carbon leakage” resulting from the increased EU climate ambition could lead to increase total global emissions. The CBAM carbon adjustment price on selected types of imported products in the iron steel, aluminium, cement, electricity, fertilizers sectors would level the playing field between EU and imported products.

<sup>35</sup> Under EU law, every EU worker has certain minimum rights relating to protection against discrimination based on sex, race, religion, age, disability and sexual orientation, labour law (part-time work, fixed-term contracts, working hours, informing and consulting employees). A summary is available at [https://eur-lex.europa.eu/summary/chapter/employment\\_and\\_social\\_policy.html?root\\_default=SUM\\_1\\_CODED%3D17&locale=en](https://eur-lex.europa.eu/summary/chapter/employment_and_social_policy.html?root_default=SUM_1_CODED%3D17&locale=en).

<sup>36</sup> Joint Communication to the European Parliament and the Council on the EU Action Plan on Human Rights and Democracy 2020-2024 (JOIN/2020/5 final).

<sup>37</sup> Communication from the Commission on the EU strategy on the rights of the child (COM/2021/142 final).

<sup>38</sup> Communication from the Commission on the EU Strategy on Combatting Trafficking in Human Beings 2021- 2025 (COM(2021) 171 final).  
(COM(2022)66 final).

<sup>39</sup> E.g. Pillar 10 of European Pillar of Social Rights on healthy, safe and well-adapted work environment and Article 7(b) International Covenant on Economic, Social and Cultural Rights (see annex of this Directive) on just and favourable conditions at work including safe and healthy working conditions.

agriculture). Therefore, internally it would also reinforce the protection of workers in the Union alongside the existing social *acquis* and contribute to preventing and tackling abuses within and across Member States.

Thus, this Directive will complement the EU's regulatory environment that currently does not include an Union-wide transparent and predictable framework that helps EU companies in all sectors of the economy to assess and manage sustainability risks and impacts with respect to the core human rights and environmental risks, including across their value chains.

## 2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

### Legal basis

The proposal is based on Article 50 and Article 114 of the Treaty on the Functioning of the European Union (TFEU).

Article 50(1) TFEU and in particular Article 50(2)(g) TFEU provide for the EU competence to act in order to attain freedom of establishment as regards a particular activity, in particular “*by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or forms within the meaning of the second paragraph of Article 54 TFEU with a view to making such safeguards equivalent throughout the Union*”. An example of this can be coordination measures concerning the protection of interests of companies' shareholders and other stakeholders with a view to making such protection equivalent throughout the Union, where disparities between national rules are such as to obstruct freedom of establishment<sup>41</sup>. Recourse to this provision is possible if the aim is to prevent the emergence of current or future obstacles to the freedom of establishment resulting from the divergent development of national laws. The emergence of such obstacles must be likely and the measure in question must be designed to prevent them.<sup>42</sup>

This proposal regulates sustainability due diligence obligations of companies and at the same time covers – to the extent linked to that due diligence – corporate directors' duties and corporate management systems to implement due diligence. Thus, the proposal concerns processes and measures for the protection of the interests of members and stakeholders of the companies. Several Member States have recently introduced legislation on sustainability due diligence,<sup>43</sup> while others are in the process of legislating or considering action<sup>44</sup>. Also, an increasing number of Member States have recently been regulating the matter by requiring directors to take into account the company's external impacts<sup>45</sup>, prioritize the interests of

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<sup>41</sup> It is recalled that as regards corporate governance measures, the EU has already legislated based on the same legal basis, e.g. Shareholders Rights Directives I and II.

<sup>42</sup> See e.g. Case C 380/03 Germany v Parliament and Council [2006] ECR I-11573, paragraph 38 and the case-law cited.

<sup>43</sup> See footnote 3. As regards EEA countries, Norway has adopted due diligence legislation.

<sup>44</sup> Austria, Belgium, Denmark, Finland, Italy, Luxembourg, the Netherlands (regarding broader legislation on responsible business conduct). There are civil society campaigns in favour of introducing due diligence legislation ongoing in Ireland, Spain and Sweden. Annex 8 of the Impact Assessment accompanying this proposal provides a detailed overview on Member State/EEA laws and initiatives.

<sup>45</sup> French *Loi Pacte*.

stakeholders in their decisions<sup>46</sup>, or adopt a policy statement on the company's human rights strategy<sup>47</sup>. New and emerging laws on due diligence are considerably different in the Union despite the intention of all the Member States to build on existing international standards (UN Guiding Principles on Business and Human Rights OECD Responsible Business Conduct standards) and thus lead to diverging requirements. Certain Member States have adopted, or are likely to adopt, legislation that is limited to specific sustainability concerns in value chains.<sup>48</sup> Personal scope, substantive due diligence requirements, enforcement regimes and related directors' duties diverge and may do so even more in the future.<sup>49</sup> Other Member States can be expected to decide not to legislate in this field. Significantly different requirements among Member States thus create fragmentation of the internal market. This fragmentation is likely to increase over time.

This fragmentation also risks leading to an uneven playing field for companies within the internal market. First, companies and their directors – in particular of those which have cross-border value chains – are already subject to differing requirements and will likely be subject to even more differing requirements depending on where their registered seat is located. This creates distortions of competition. Besides, depending on how they structure their operations in the internal market, some companies may simultaneously fall within the scope of two or more different national legal frameworks dealing with sustainable corporate governance.<sup>50</sup> This could lead to duplication of requirements, difficulties in complying, lack of legal certainty for companies, and even mutually incompatible parallel legal requirements. Inversely, some companies may not fall within the scope of any national framework for the mere reason that they do not have links relevant under national law with the jurisdiction of a Member State that has due diligence rules in place and thereby gaining an advantage over their competitors.

The proposed act is designed to prevent and remove such obstacles to free movement and distortions of competition by harmonising the requirements for companies to carry out due diligence in their own operation, subsidiaries and value chains and related directors' duties. They will lead to a level playing field where companies of similar size and their directors are subject to the same requirements for integrating sustainable corporate governance and corporate due diligence measures in their internal management systems and thereby protecting the interests of the company's stakeholders in a similar way. Harmonised conditions would be beneficial for cross-border establishment including company operations and also investments, since it would facilitate comparison of corporate sustainability requirements and make engagement easier and thus less costly.

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<sup>46</sup> For example the Netherlands.

<sup>47</sup> See the German *Sorgfaltspflichtengesetz*).

<sup>48</sup> For instance, the Dutch law referred to above sets up horizontal mandatory due diligence for child labour concerns through the whole value chain. In Austria, a political party referred a draft bill on social responsibility regarding forced and child labour in the garment sector.

<sup>49</sup> The French *Loi relative au devoir de vigilance* and the German *Sorgfaltspflichtengesetz* differ considerably in terms of personal scope material requirements and enforcement regime.

<sup>50</sup> For instance, pursuant to the German *Sorgfaltspflichtengesetz*, any company with a branch office and at least 3000 employees in Germany (1000 as from 2024) fall within the scope of the law.

Article 50 TFEU is *lex specialis* for measures adopted in order to attain freedom of establishment. Among the proposed measures, those concerning companies' corporate governance fall under this legal basis, in particular integrating due diligence into companies' policies, measures on companies' plan to ensure that the business model and strategy 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, and related remuneration measures, as well as provisions on directors' duty of care, and directors' duties concerning setting up and overseeing due diligence.

In order to address the described internal market barriers comprehensively, Article 50 TFEU is here combined with the general provision of Article 114 TFEU. Article 114 TFEU provides for the adoption of measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market. The Union legislature may have recourse to Article 114 TFEU in particular where disparities between national rules are such as to obstruct the fundamental freedoms or create distortions of competition and thus have a direct effect on the functioning of the internal market.

As set out above, the differences between national rules on sustainable corporate governance and due diligence obligations have a direct impact on the functioning of the internal market, and that impact is likely to increase in the future. Beyond the matters regulated in Article 50 TFEU, this act concerns other areas of the establishment and functioning of the internal market. Notably, in the absence of action by the Union legislator, the production and movement of goods and services would be skewed to the benefit of jurisdictions with no due diligence regimes or with less demanding regimes, or companies established in such jurisdictions, substantially impacting the flow of goods and services. Moreover, companies supplying goods or services, in particular SMEs, will be confronted with diverging rules and expectations from customers located in different Member States. For instance, whilst one Member State law may require the supplier to carry out third-party audits, another Member State may require the same supplier to participate in a recognised industry schemes and multi-stakeholder initiatives. One Member State may require the company to carry out due diligence in relation to established business relationships whilst the other Member State may cover the direct suppliers only. This would lead to a multiplication of different partially incompatible requirements distorting the free flow of goods and services in the Union.

It is foreseeable that these distortions and impacts would become more serious with time as more and more Member States will adopt diverging national laws or may even lead to a race to the bottom in forthcoming due diligence legislations.

Distortions are also relevant for civil liability in case of harm caused in a company's value chain. Some national legal frameworks on due diligence include an express civil liability regime linked to the failure to execute due diligence, while others expressly exclude a specific civil liability regime.<sup>51</sup> A number of companies have been brought before courts for causing

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<sup>51</sup> The French *Loi relative au devoir de vigilance* includes a provision on civil liability. The German *Sorgfaltspflichtengesetz* clarifies that a violation of an obligation under the law does not give rise to any civil liability while general liability rules remain unaffected. Moreover national civil liability legislations are not harmonized.

or failing to prevent adverse impacts at the level of their subsidiaries or value chains. Such cases are decided based on differing rules today. In the absence of common rules, divergent national liability regimes may lead to different outcomes depending on whether there is ownership control (as regards subsidiaries) or factual control (either through direct contracts or where control could be exercised by the company through contractual cascading or other leverage in indirect business relationships). This fragmentation would lead to distortions of competition in the internal market as a company located in one Member State would be subject to damages claims due to harm caused in its value chain whilst a company with the same value chain would be exempt from this financial and reputational risk because of diverging national rules.

The proposed civil liability regime would clarify which rules apply in case harm occurs in a company's own operation, at the level of its subsidiaries and at the level of direct and indirect business relations in the value chain. In addition, the proposed provision on applicable law serves the purpose of ensuring application of the harmonised rules, including on civil liability, also in cases where otherwise the law applicable to such claim is not the law of a Member State. It will therefore be essential to ensure the necessary level-playing field.

### **Subsidiarity**

First, Member States' legislation alone in the area is unlikely to be sufficient and efficient. As regards specific transboundary problems, such as pollution, climate change, biodiversity etc. individual action is hampered in case of inaction by other Member States. The achievement of international commitments such as the goals of the UNFCCC<sup>52</sup>'s Paris Agreement on climate change, the Convention on Biological Diversity, as well as other multilateral environmental agreements by individual Member State action alone is unlikely. Furthermore, risks resulting from adverse human rights and environment impacts present in companies' value chains have often cross-border effects (e.g. pollution, transnational supply and value chains).

Second, many companies are operating EU-wide or globally; value chains expand to other Union Member States and increasingly to third countries. Institutional investors which invest across the borders own a large part (38%<sup>53</sup>) of the total market capitalisation of large European listed companies, therefore many companies have cross-border ownership and their operations are influenced by regulations in some countries or lack of action in others. This is one of the reasons why frontrunner companies arguably are reluctant to do a further steps in addressing sustainability issues including those in the value chains today<sup>54</sup> and ask for a cross-border level playing field.

Third, companies operating across the internal market and beyond need legal certainty and a level-playing field for their sustainable growth. Some Member States have recently introduced legislation on due diligence<sup>55</sup>, while others are in the process of legislating or

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<sup>52</sup> United Nations Framework Convention on Climate Change

<sup>53</sup> This number comes from the Impact Assessment of the Shareholders Rights Directive II.

<sup>54</sup> E.g. food producer Danone has recently been forced to cut costs by investors on grounds of lack of short-term profitability, see article *Can Anglo-Saxon activist investors whip Danone into shape?*, available at <https://www.economist.com/business/2021/02/20/can-anglo-saxon-activist-investors-whip-danone-into-shape>.

<sup>55</sup> See footnote 3.

considering action<sup>56</sup>. Existing Member State rules and those under preparation already have, and would further lead to diverging requirements, which risks being inefficient and leading to an uneven playing field. There are considerable indirect effects of diverging due diligence laws on the suppliers that supply to different companies falling under different laws, as the obligations are in practice translated into contractual clauses. If due diligence requirements are significantly different among Member States, this creates legal uncertainty, fragmentation of the Single market, additional costs and complexity for companies and their investors operating across borders as well as other stakeholders. EU action can avoid this and therefore has added value.

Finally, compared to individual action by Member States, EU intervention can ensure a strong European voice in policy developments at the global level<sup>57</sup>.

### **Proportionality**

The burden on companies stemming from compliance costs, has been adapted to the size, resources available, and the risk profile. Companies will only have to take appropriate measures that are commensurate with the degree of severity and the likelihood of the adverse impact, and reasonably available to the company, taking into account the circumstances of the specific case, including characteristics of the economic sector and of the specific business relationship and the company's influence thereof, and the need to ensure prioritisation of action. For that purpose the material and personal scope, and the enforcement provisions were restricted as further explained below.

As regards the “personal scope” of the due diligence obligations (i.e. which business categories are covered), small and medium sized enterprises (SMEs) that include micro companies and overall account for around 99 % of all companies in the Union, are excluded from the due diligence duty. For this category of companies, the financial and administrative burden of setting up and implementing a due diligence process would be relatively high. For the most part, they do not have pre-existing due diligence mechanisms in place, they have no know-how, specialised personnel, and the cost of carrying out due diligence would impact them disproportionately. They will, however, be exposed to some of the costs and burden through business relationships with companies in scope as large companies are expected to pass on demands to their suppliers. Hence, supporting measures will be necessary to help SMEs build operational and financial capacity. Companies whose business partner is an SME, are also required to support them in fulfilling the due diligence requirements, in case such requirements would jeopardize the viability of the SME. Moreover, the value chain of the financial sector does not cover SMEs that are receiving loan, credit, financing, insurance or reinsurance. At the same time, exposure of an individual SME to adverse sustainability impacts will as a general rule be lower than the exposure of larger companies. Therefore, very

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<sup>56</sup> See footnote 44.

<sup>57</sup> In 2014, the UN Human Rights Council decided to establish an open-ended intergovernmental working group (OEIGWG) on transnational corporations and other business enterprises with respect to human rights, whose mandate shall be to elaborate an international legally binding instrument (LBI) to regulate, in international human rights law, the activities of transnational corporations and other business enterprises. In 2021, the OEIGWG released a third revised draft LBI on business activities and human rights, including due diligence measures and corporate liability for human rights abuses.

large companies<sup>58</sup> will be within the scope of the full due diligence obligation, also because many of them already have certain processes in place e.g. because of reporting obligations. In particular, the selected turnover criteria will filter those having the largest impact on the Union economy. Moreover, this Directive lays down measures to limit the passing on of the burden from those large companies to the smaller suppliers in the value chain and to use fair, reasonable, non-discriminatory and proportionate requirements *vis-a-vis* SMEs.

As far as companies with lower turnover and less employees<sup>59</sup> are concerned, the due diligence obligation is limited to those companies active in particularly high-impact sectors that are at the same time covered by existing sectoral OECD guidance<sup>60</sup>. Moreover, despite the fact that OECD guidance covers the financial sector, it is not included in the high-impact sectors due to its specificities. This limitation aims to create a balance between the interest in achieving the goals of the Directive and the interest in minimising the financial and administrative burden on companies. The due diligence obligation for these companies will be simplified as they would only focus on severe adverse impacts that are relevant for their sector. Moreover, the due diligence obligation will apply to them only 2 years after the end of the transposition period for this Directive allowing to establish the necessary processes and procedures and benefit from industry cooperation, technological developments, standards, etc. that are likely to be prompted by the earlier implementation date for larger companies.

To the extent that this Directive also covers third-country companies, the criteria used for defining the scope of EU and non-EU companies covered are not the same, but ensure that third country companies are not more likely to fall within the scope. For them, a net turnover threshold is used (EUR 150 million for group 1 and EUR 40 million for group 2), but all of this turnover needs to be generated in the Union. EU companies, in turn, have to have a net turnover of EUR 150 million generated worldwide and have to fulfil an employee criterion as well (above 500 employees in group 1 and above 250 employees in group 2). Such difference in the criteria used is justified for the following reasons:

- The EU turnover criterion for third-country companies creates a link to the EU. Including only turnover generated in the Union is justified since such a threshold, appropriately calibrated, creates a territorial connection between the third-country companies and the Union by the effects that the activities of these companies may have on the EU internal market, which is sufficient for the Union law to apply to third-country companies.
- Also, the Country-by-Country Reporting Directive – an amendment to the Accounting Directive – has already established the methods for calculating net turnover for non-EU companies, while such methodology does not exist for

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<sup>58</sup> Large limited liability companies with more than 500 employees and a net turnover of more than EUR 150 million.

<sup>59</sup> Large limited liability companies with more than 250 employees and a net turnover of more than EUR 40 million but not simultaneously exceeding both the 500 employee and the net turnover EUR 150 million net turnover thresholds, as well as third-country companies of a comparable legal form with a net EU turnover of EUR 40 to 150 million.

<sup>60</sup> The OECD developed such sectoral guidance in order to promote the effective observance of OECD Guidelines on Multinational Enterprises. See the list of sectoral guidance documents at: <http://mneguidelines.oecd.org/sectors/>.



calculating the number of employees of third-country companies. The experience with the French law regulating due diligence shows that, in the absence of a common definition of an employee<sup>61</sup>, the number of employees (worldwide) is difficult to calculate, which hinders the identification of which third-country companies are covered by the scope, preventing effective enforcement of the rules.

- Using both employee and turnover criteria for EU companies would ensure better alignment with the proposal for a Corporate Sustainability reporting Directive which should be used for the reporting of due diligence measures and policy for EU companies.
- While the Directive will cover about 13 000 EU companies<sup>62</sup>, based on the estimations of the Commission, it will only cover about 4 000 third-country companies<sup>63</sup>. The fact that EU companies will only be covered if they also reach the minimum limit on the number of employees is very unlikely to change the conditions of competition in the EU internal market: the two size criteria applicable to EU companies, even if cumulative, will result in still covering relatively smaller companies compared to non-EU companies due to the fact that, in their case, the entire worldwide net turnover of the company is to be taken into account.

Finally, large third-country companies having a high turnover in the Union have the capacity to implement due diligence and will benefit from the advantages coming with due diligence also in their operations elsewhere. In all other aspects, third-country companies are covered by the due diligence rules the same way as their EU counterparts (for example as regards the regime applicable to companies operating in high-impact sectors and identical phase in period for those companies). The harmonisation of the duties of directors is limited to EU companies only, thus third-country companies will have more restricted obligations.

The “material scope” is focused and structured mainly upon the corporate due diligence obligation and covers human rights and those environmental adverse impacts that can be clearly defined in selected international conventions. Directors’ duties proposed ensure a close link with the due diligence obligations and are thus necessary for the due diligence to be effective. Directors’ duties also include the clarification of how directors are expected to comply with the duty of care to act in the best interest of the company.

Effective enforcement of the due diligence duty is key to achieving the objectives of the initiative. This Directive will provide for a combination of sanctions and civil liability.

As regards private enforcement through civil liability, a different approach is used regarding the company’s own operations and its subsidiaries on the one hand and regarding business relations on the other hand. In particular, civil liability concerns only established business relationships with which a company expects to have a lasting relationship, in view of its

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<sup>61</sup> For the Union see for example Article 5 of the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized companies (2003/361/EC) (OJ L 124, 20.5.2003, p. 36).

<sup>62</sup> In group 1: 9 400 companies, in group 2: 3 400 companies.

<sup>63</sup> In group 1: 2 600 companies, in group 2: 1 400 companies. The methodology used for calculating the number of third-country companies is explained in the accompanying Staff Working Document.

intensity or duration and which does not represent a negligible or merely ancillary part of the company's value chain. The company should not be liable for failing to prevent or cease harm at the level of indirect business relationships if it used contractual cascading and assurance and put in place measures to verify compliance with it, unless it was unreasonable, in the circumstances of the case, to expect that the action actually taken, including as regards verifying compliance, would be adequate to prevent, mitigate, bring to an end or minimise the extent of the adverse impact. In addition, in the assessment of the existence and extent of liability, due account is to be taken of the company's efforts, insofar as they relate directly to the damage in question, to comply with any remedial action required of them by a supervisory authority, any investments made and any targeted support provided as well as any collaboration with other entities to address adverse impacts in its value chains.

This approach to civil liability will also limit the risk of excessive litigation.

The measures related to public enforcement of the due diligence duty do not go beyond what is necessary. This Directive clarifies that any sanction imposed due to non-compliance with the due diligence obligations has to be proportionate. If the public authorities that investigate the company's compliance with this Directive identify a failure to comply they should first grant the company an appropriate period of time to take remedial action. The Directive outlines a limited number of sanctions that should apply in all Member States but leaves it to the Member States to ensure a proportionate enforcement process, in line with their national law. When pecuniary sanctions are imposed, they shall be based on the company's turnover to ensure their proportionate level.

Furthermore, this Directive does not entail unnecessary costs for the Union, national governments, regional or local authorities. The Directive will leave it up to the Member States how to organise enforcement. Supervision can be carried out by existing authorities. To reduce the costs (for instance when supervising third-country companies active in various Member States) and improve the supervision, coordination, investigation and exchange of information the Commission will set up a European Network of Supervisory Authorities.

This Directive allows for company cooperation, use of industrial schemes and multi-stakeholder initiatives to reduce the cost of compliance for the companies with this Directive.

### **Choice of the instrument**

The proposed instrument is a Directive, since Article 50 TFEU is the legal basis for company law legislation regarding the protection of the interests of companies' members and others with a view to making such protection equivalent throughout the Union. Article 50 TFEU requires the European Parliament and the Council to act by means of directives.

The Commission shall adopt delegated acts laying down the criteria for the reporting by third country companies on due diligence.

In order to provide support to companies and to Member State authorities on how companies should fulfil their due diligence obligations, the Commission, where necessary in consultation with relevant European bodies, international bodies having expertise in due diligence implementation, and others, may issue guidelines. Guidelines may also be used to outline non-binding model contractual clauses that companies can use when cascading the obligation in their value chain.

In addition, the Commission may put in place other supporting measures building on existing EU actions and tools to support due diligence implementation within the Union and in third countries, including facilitation of joint stakeholder initiatives to help companies fulfil their obligations and support SMEs impacted by this Directive in other ways. This may be further complemented by EU development cooperation instruments to support third country

governments and upstream economic operators in third countries addressing adverse human rights and environmental impacts of their operations and upstream business relationships.

### **3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS**

#### **Stakeholder consultations**

In line with the better regulation guidelines, several consultation activities have taken place:

- The inception impact assessment (roadmap), which received 114 feedbacks;
- The open public consultation<sup>64</sup>, which received 473 461 responses and 122.785 citizen signatures, the vast majority of which were submitted through campaigns using pre-filled questionnaires, and 149 position papers;
- A dedicated consultation of social partners;
- A number of stakeholder workshops and meetings, e.g. meeting of the Informal Company Law Expert Group, mainly composed of company law legal academics (ICLEG), meeting with Member State representatives in the Company Law Expert Group (CLEG); and
- Conferences and meetings with business associations, individual businesses, including Small and Medium-sized Enterprises (SMEs) representatives, civil society, including non-governmental and not-for-profit organisations, as well as international organisations, such as OECD.

Overall, the consultation activities showed that there is generally a wide acknowledgement among stakeholders of the need for an EU legal framework for due diligence.<sup>65</sup> In particular, large companies across the board asked for greater harmonisation in the area of due diligence to improve legal certainty and create a level playing field. Citizens and civil society associations perceived the current regulatory framework as ineffective to ensure corporate accountability for negative impacts on the human rights and environment.

A vast majority of respondents to the open public consultation, including most participating Member States, were in favour of a horizontal approach to due diligence over a sector-specific or thematic approach<sup>66</sup>. Companies indicated that they feared the risk of competitive disadvantages vis-à-vis third-country companies that do not have the same duties. Accordingly, most respondents agreed that due diligence rules should also apply to third-

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<sup>64</sup> Summary of the open public consultation for the initiative on sustainable corporate governance, available at [https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/public-consultation\\_en](https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/public-consultation_en).

<sup>65</sup> For instance, in response to the open public consultation, NGOs supported the need for action with 95.9%, companies with 68.4% (large companies with 75.5%, SMEs with 58.7 %) and business associations with 59.6 %.

<sup>66</sup> While 97.2% of NGOs preferred a horizontal approach, overall companies did so with 86.8%, including SMEs (81.8%), as well as business association (85.3%). This is true also for Member States respondents.

country companies which are not established in the EU but carry out activities of a certain scale in the EU<sup>67</sup>.

Regarding an enforcement mechanism accompanying a mandatory due diligence duty, all stakeholder groups responding to the open public consultation indicated by a majority that supervision by competent national authorities with a mechanism of EU cooperation/coordination is the most suited option.<sup>68</sup>

A majority of respondents in all stakeholder groups considered binding rules with targets to be the option entailing the most costs, but also the most benefits overall. Although most respondents saw the positive impact on third countries, a subset of respondents fear a potential negative impact of due diligence rules on third countries if companies investing in third countries with weak human rights, including social and labour, and environmental protection, would have to withdraw from these countries.

Detailed information on the consultation strategy and conclusions of the stakeholder consultations can be found in Annex 2 of the impact assessment report.

### **Collection and use of expertise**

To support the analysis of the different options, the Commission awarded support contracts to external experts for a study on due diligence requirements through the supply chain<sup>69</sup> and for a study on directors' duties and sustainable corporate governance<sup>70</sup>. These experts worked in close cooperation with the Commission throughout the different phases of the study.

Besides these support studies, additional expertise was identified through literature research and through the stakeholder consultation responses.

Alongside the above-mentioned support studies, expert group meetings, and stakeholder consultations, the Commission also paid close attention to the relevant European Parliament resolution and to the Council Conclusions. The European Parliament resolution of 10 March 2021 provided recommendations to the Commission on corporate due diligence and corporate accountability, calling upon the Commission to propose EU rules for a comprehensive corporate due diligence obligation. The Council Conclusions on Human Rights and Decent Work in Global Supply Chains of 1 December 2020 called upon the Commission to table a proposal for an EU legal framework on sustainable corporate governance, including cross-sector corporate due diligence obligations along global value chains.

### **Impact assessment**

The analysis in the impact assessment addressed in a broad sense the problem arising from the need to reinforce sustainability in corporate governance and management systems, with two

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<sup>67</sup> 97 % of respondents agreed to this statement (NGOs 96.1%, business associations 96.5%, companies 93.8%, including SMEs 86.4%). All Member State respondents agree with this statement as well.

<sup>68</sup> It was followed by the option of judicial enforcement with liability (49%) and supervision by competent national authorities based on complaints about non-compliance with effective sanctions (44%).

<sup>69</sup> See reference in footnote 8.

<sup>70</sup> European Commission, Directorate-General for Justice and Consumers, Study on directors' duties and sustainable corporate governance: final report, Publications Office, 2020, <https://data.europa.eu/doi/10.2838/472901>. <https://data.europa.eu/doi/10.2838/472901>.

dimensions: (1) stakeholder interests and stakeholder-related (sustainability) risks to companies are not sufficiently taken into account in corporate risk management systems and decisions; (2) companies do not sufficiently mitigate their adverse human rights and environmental impacts, do not have adequate governance, management systems and measures to mitigate their harmful impacts.

After consideration of different policy options mainly in the areas of corporate due diligence duty and directors' duties, the impact assessment proposed a preferred package of policy options across three elements: corporate due diligence, directors' duties and remuneration, which complement each other.

The draft impact assessment was submitted to the Commission's Regulatory Scrutiny Board on 9 April 2021. Following the negative opinion by the Board, a revised impact assessment was submitted to the Board for a second opinion on 8 November 2021. While noting the significant revision of the report in response to the Board's first opinion, the Board nevertheless issued a second negative opinion on 26 November 2021<sup>71</sup>, which underlined the need for political guidance on whether, and under which conditions, the sustainable corporate governance initiative could proceed further. The Board maintained its negative opinion because it considered that the impact assessment report did not sufficiently (1) address the problem description and provide convincing evidence that EU businesses, in particular SMEs, do not already sufficiently reflect sustainability aspects or do not have sufficient incentives to do so; (2) present a scope of policy options and identify or fully assess key policy choices; (3) assess the impacts in a complete, balanced and neutral way and reflect uncertainty related to the realisation of benefits, and (4) demonstrate the proportionality of the preferred option.

Therefore, in order to address the comments of the Board's second negative opinion, the impact assessment is complemented by a staff working document on the follow-up of the Board's opinion that provides additional clarifications and evidence on the areas where the Board had provided specific suggestions of improvements.

According to the Commission's Better Regulation rules a positive opinion from the Regulatory Scrutiny board is required for a file to proceed to the adoption stage. However, the Vice President for Inter-Institutional Relations and Foresight can allow for the continuation of the preparations for an initiative that has been subject to a second negative opinion by the Regulatory Scrutiny Board. It is important to flag that the opinions of the Regulatory scrutiny Board are an assessment of the quality of the impact assessment and not an assessment of the related legislative proposal.

The Commission, also in the light of the agreement by the Vice-President for Inter-Institutional Relations and Foresight, has considered it opportune to proceed with the initiative for the following reasons:

- the *political importance* of this initiative for the Commission's political priority of "An economy that works for people", including within the context of the Sustainable Finance package and the European Green Deal and

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<sup>71</sup> SEC(2022)95

- the *urgency of action* in the field of value chain due diligence as contribution to the sustainability transition, and to address the risk of the increasing Single market fragmentation, as well as the view that
- the *additional clarification and evidence* provided satisfactorily addressed the shortcomings of the impact assessment identified by the Regulatory Scrutiny Board and were considered in the adapted legal proposal.

With regard to its importance and urgency, the Commission also took note that the initiative was included in the Joint Political Priorities for 2022 by the European Parliament, the Council and the Commission.

After careful analysis of the Board’s findings and considering the reflections on the additional clarifications and evidence provided, the Commission considers that the proposal, which has been significantly revised as compared to the package of policy options put forward by the impact assessment, allows still to decisively move forward towards the overall objective to better exploit the potential of the single market to contribute to the transition to a sustainable economy and to foster long-term sustainable and responsible corporate behaviour. The Directive is more focused and targeted compared to the preferred option outlined in the draft impact assessment. The core of it is the due diligence obligation, while significantly reducing directors’ duties by linking them closely to the due diligence obligation. In addition, the scope of due diligence is adapted. A detailed description of the adaptations made to the preferred option package of the impact assessment can be found in the accompanying Staff Working Document that presents the follow-up to the opinion of the Regulatory Scrutiny Board and additional information.

In short, the “personal scope” i.e. which business categories are covered has been significantly reduced following reflections triggered by the Board’s comments on the problem description, in particular with regard to SMEs, and on the proportionality of the preferred option. Concretely, SMEs have been completely excluded, from the scope, and the coverage of high-impact sectors has been shifted only to companies having more than 250 employees and more than EUR 40 million worldwide net turnover (while large companies which simultaneously exceed both the 500 employee and the EUR 150 million worldwide net turnover limits are covered by the scope irrespective of their sectors of economic activities. The high-impact sectors are directly defined in the text, thus also reflecting on the Board’s comments as regards legislative technique. The definition of high-impact sectors has been limited to sectors with high risk of adverse impacts and for which OECD guidance exists. For midcap companies in high-impact sectors, the rules will start to apply after a transition period of two years to allow for a longer adaptation period. In addition, the due diligence obligations of these companies are limited only to severe impacts relevant for their sector.

To reach the objectives of the initiative effectively, the scope of this proposal extends to companies from third countries. Only such non-EU companies are covered which have a direct link to the Union market, and which meet the similar turnover threshold as EU companies but within Union market. Furthermore, they will face the same obligations regarding due diligence as the respective EU companies.

The Directive also indicates that accessible and practical support is necessary for companies, in particular SMEs in the value chain, to prepare for the obligations (or the consequent demands they may be passed on to them indirectly). This could include practical guidance and supporting tools such as hotlines, databases or training, as well as the setup of an observatory to help companies with the implementation of the Directive. Moreover, the review clause makes explicit reference to the personal scope of the Directive (i.e. coverage of business categories), which should be reviewed in light of the practical experiences with the

application of the legislation. Other mitigation measures to reduce indirect impact on the SMEs are part of the obligations of companies in the scope of this Directive.

As regards the material scope (i.e. what is covered), a cross-cutting instrument covering human rights and environmental impacts has been retained. This reflects the strong consensus amongst stakeholder groups that a horizontal framework is necessary to address the identified problems.

Furthermore, the Board commented that the impact assessment is not sufficiently clear about the need to regulate directors' duties on top of due diligence requirements. The Commission therefore decided to address this issue by deviating from the preferred options' package in the impact assessment and focussing on the directors' duties element, in light also of the existing international standards<sup>72</sup>, on due diligence and duty of care. This encompasses directors' duties relating to the setting up and overseeing the implementation of corporate due diligence processes and measures, establishing code of conduct for this purpose as well as integrating due diligence into the corporate strategy. In order to fully reflect the role of directors in light of the corporate due diligence obligations, the directors' general duty of care for the company, which is present in the company law of all Member States, is also being clarified providing that when fulfilling their duty to act in the best interest of the company, directors should take into account the sustainability matters of the proposal for a corporate sustainability reporting Directive, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term horizons. Further reaching specific directors' duties that had been put forward in the impact assessment are not retained. This will ensure that the proposal delivers on its objective while remaining proportionate.

With regard to comments of the Board, this Explanatory Memorandum as well as the recitals of the legislative proposal contain comprehensive explanations of the policy choices made. While the impact assessment submitted to the Board and the Board's opinion have been published unchanged, a separate accompanying Staff Working Document has been prepared to provide additional evidence and clarifications that follows up on the Board's remarks including as regards evidence. This document addresses in particular the following:

1. Problem description:
  - the scale and evolution of the environmental and sustainability problems directly linked to the apparent absence or insufficient use of corporate sustainability management practices by EU companies to be tackled by this Directive and the added value of the Directive in relation to the comprehensive package of measures to promote sustainability under the Green Deal;
  - why the market and competitive dynamics together with the further evolution of companies' corporate strategies and risk management systems are considered insufficient and as regards the assumed causal link between using corporate sustainability tools and their practical effect in tackling the problems;
2. Impacts of the preferred option:

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<sup>72</sup> See footnote 6.

- issues related to third countries, integrating observations (i) on expected developments in third countries (including taking into account EU and international trade and development support measures), (ii) on impacts on third countries and on suppliers in third countries;
- the enforcement mechanism, further expanding on the added value of a two-pillar enforcement system that builds on administrative enforcement and civil liability;
- impacts on competition and competitiveness.

### **Regulatory fitness and simplification**

Small and medium-sized enterprises, including micro enterprises are not included in the scope and indirect effects on them will be mitigated through supporting measures and guidelines at Union and Member State level as well in business to business relations with the use of model contractual clauses and by proportionality requirements for the larger business partner.

### **Fundamental rights**

As explained in the impact assessment and based on existing evidence, mandatory due diligence requirements can have significant benefits for the protection and promotion of fundamental rights.

## **4. BUDGETARY IMPLICATIONS**

There are no direct implications to the Union budget.

## **5. OTHER ELEMENTS**

### **Implementation plans and monitoring, evaluation and reporting arrangements**

The Commission will set up a European Network of Supervisory Authorities to help with the implementation of this Directive. Such Network will be composed by the representatives of the supervisory authorities designated by the Member States and where necessary joined by other Union agencies with relevant expertise in the areas covered by this Directive, to ensure compliance by the companies of their due diligence obligations, in order to facilitate and ensure the coordination and convergence of regulatory, investigative, sanctioning and supervisory practices, and the sharing of information among these supervisory authorities.

After seven years following the end of the transposition period, the Commission shall report on the implementation of this Directive, including, among other aspects, its effectiveness. The report shall be accompanied, if appropriate, by a legislative proposal.

In order to provide clarity and support to companies and Member States with the implementation of the directive, the Commission will issue guidance, where necessary.

### **Explanatory documents**

To ensure the proper implementation of this Directive, the explanatory document, e.g. in the form of correlation tables would be necessary.

### **Detailed explanation of the specific provisions of the proposal**

Article 1 sets out the subject matter of the Directive, i.e. laying down rules on obligations of due diligence by companies regarding actual and potential human rights and environmental adverse impacts, with respect to their own operations, the operations of their subsidiaries, and the value chain operations carried out by established business relationships; the provision also



specifies that this Directive establishes rules on liability for violations of the due diligence obligation.

Article 2 establishes the personal scope of application of the Directive and sets out the criteria based on which a Member State is competent to regulate matters covered in this Directive.

Article 3 contains definitions for the purpose of this Directive.

Article 4 requires Member States to ensure that companies conduct human rights and environmental due diligence by complying with the specific requirements listed in Articles 5 to 11 of the Directive.

Article 5 requires Member States to ensure that companies integrate due diligence into all corporate policies and have in place a due diligence policy that is updated annually. The provision specifies that this policy should include a description of the company's approach to due diligence, of a code of conduct to be followed by the company's employees and subsidiaries, of the processes put in place to implement due diligence.

Article 6 establishes the obligation for Member States to ensure that companies take appropriate measures to identify actual or potential adverse human rights and environmental impacts in their own operations, in their subsidiaries and at the level of their established direct or indirect business relationships in their value chain.

Article 7 sets out the requirement for Member States to ensure that companies take appropriate measures to prevent potential adverse impacts identified pursuant to Article 6, or to adequately mitigate those impacts, where prevention is not possible or requires gradual implementation.

Article 8 establishes the obligation for Member States to ensure that companies take appropriate measures to bring to an end actual adverse human rights and environmental impacts that they had or could have identified pursuant to Article 6. Where an adverse impact that has occurred at the level of established direct or indirect established business relationships cannot be brought to an end, Member States should ensure that companies minimise the extent of the impact.

Article 9 sets out the obligation for Member States to ensure that companies provide for the possibility to submit complaints to the company in case of legitimate concerns regarding those potential or actual adverse impacts, including in the company's value chain. Companies are required to grant this possibility to persons who are affected or have reasonable grounds to believe that they might be affected by an adverse impact, to trade unions and other workers' representatives representing individuals working in the value chain concerned, and to civil society organisations active in the area concerned.

Article 10 introduces the obligation for Member States to require companies to periodically assess the implementation of their due diligence measures in order to verify that adverse impacts are properly identified and that preventive or corrective measures are implemented, and to determine the extent to which adverse impacts have been prevented or brought to an end or their extent minimised.

Article 11 establishes the obligation for Member States to ensure that companies that are not subject to reporting requirements under Directive 2013/34/EU report on the matters covered by this Directive and publish an annual statement on their website.

Article 12 sets out the obligation for the Commission to adopt guidance about non-binding model contract clauses to help companies comply with Article 7(2), point (b), and Article 8(3) point (c).

Article 13 sets out the possibility for the Commission, in order to provide support to companies or to Member State authorities on how companies should fulfil their due diligence obligations, to issue guidelines, for specific sectors or specific adverse impacts, in consultation with the European Union Agency for Fundamental Rights, the European Environment Agency, and where appropriate with international bodies having expertise in due diligence.

Article 14 requires the Member States and Commission to provide accompanying measures to companies in the scope of this Directive actors and to actors along global value chains that are indirectly impacted by the obligations of the Directive. Such support can range from the operation of dedicated websites, portals or platforms to financial support to SMEs, and facilitation of joint stakeholder initiatives. This provision further clarifies that companies may rely on industry schemes and multi-stakeholder initiatives to support the implementation of due diligence and that the Commission, in collaboration with Member States, may issue guidance for assessing the fitness of such schemes.

Article 15 requires the Member States ensure that certain companies 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.

Article 16 introduces the requirement for companies formed in accordance with the legislation of a third country and falling within the scope of application of the present Directive pursuant to Article 2(2), to designate a sufficiently mandated authorised representative in the Union to be addressed by Member States' competent authorities, on all issues necessary for the receipt of, compliance with and enforcement of legal acts issued in relation to this Directive.

Article 17 sets out the requirement for Member States to designate one or more national supervisory authorities in order to ensure compliance by companies with their due diligence obligations and their obligation under Article 15(1) and (2) and to exercise the powers of enforcement of those obligations in accordance with Article 18.

Article 18 sets out the appropriate powers and resources of the supervisory authorities designated by the Member States to carry out their tasks of supervision and enforcement.

Article 19 establishes the requirement for Member States to ensure that any natural or legal person that has reasons to believe, on the basis of objective circumstances, that a company does not appropriately comply with the provisions of this Directive, is entitled to submit substantiated concerns, in particular in the Member State of his or her habitual residence, registered office, place of work or place of the alleged infringement, to the supervisory authorities.

Article 20 sets out that Member States shall lay down rules on sanctions applicable to infringements of the national provisions adopted pursuant to this Directive, and shall take all measures necessary to ensure that they are implemented. The sanctions shall be effective, dissuasive and proportionate. Member States shall ensure that decision of the supervisory authorities containing sanctions related to the breach of the provisions of this directive should be published.

Article 21 introduces a European Network of Supervisory Authorities composed by the representatives of the supervisory national authorities referred to in Article 16, with the aim to facilitate and ensure the coordination and alignment of regulatory, investigative, sanctioning and supervisory practices, and the sharing of information among these supervisory authorities.

Article 22 sets out the requirement for Member States to lay down rules governing the civil liability of the company for damages arising due to its failure to comply with the due

diligence obligations under specific conditions. It also introduces the obligation for Member States to ensure that the liability provided for in paragraphs 1 to 3 of this Article is not denied on the sole ground that the law applicable to such claims is not the law of a Member State.

Article 23 establishes the application of Directive (EU) 2019/1937 of the European Parliament and of the Council of 23 October 2019 on the protection of persons who report breaches of Union law, to the reporting of all breaches of this Directive and the protection of persons reporting such breaches.

Article 23 clarifies conditions of public support for companies.

Article 25 clarifies directors' duty of care.

Article 26 lays down the duty for directors of EU companies to set up and oversee the implementation of corporate sustainability due diligence processes and measures and to adapt the corporate strategy to due diligence.

Article 27 amends the Annex of Directive (EU) No 2019/1937.

Article 28 sets out the rules concerning delegated acts.

Article 29 contains a provision on the review of this Directive.

Article 30 contains provisions on the transposition of the Directive.

Article 31 sets the date of when this Directive enters into force.

Article 32 sets out the addressees of this Directive.

The lists contained in the Annex specify the adverse environmental impacts and adverse human rights impacts relevant for this Directive, to cover the violation of rights and prohibitions including the international human rights agreements (Part I Section 1), human rights and fundamental freedoms conventions (Part I Section 2), and the violation of internationally recognised objectives and prohibitions included in the environmental conventions (Part II).

Proposal for a

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937**

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 50(1) and (2)(g) and Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Economic and Social Committee<sup>73</sup>,

Acting in accordance with the ordinary legislative procedure,

Whereas:

- (1) The Union is founded on the respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights as enshrined in the EU Charter of Fundamental Rights. Those core values that have inspired the Union's own creation, as well as the universality and indivisibility of human rights, and respect for the principles of the United Nations Charter and international law, should guide the Union's action on the international scene. Such action includes fostering the sustainable economic, social and environmental development of developing countries.
- (2) A high level of protection and improvement of the quality of the environment and promoting European core values are among the priorities of the Union, as set out in the Commission's Communication on A European Green Deal<sup>74</sup>. These objectives require the involvement not only of the public authorities but also of private actors, in particular companies.

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<sup>73</sup> OJ C , , p. .

<sup>74</sup> Communication from the Commission to the European Parliament the European Council, the Council, the European Economic and Social Committee and the Committee of the Region "The European Green Deal" (COM/2019/640 final).

- (3) In its Communication on a Strong Social Europe for Just Transition<sup>75</sup>, the Commission committed to upgrading Europe’s social market economy to achieve a just transition to sustainability. This Directive will also contribute to the European Pillar of Social Rights, which promotes rights ensuring fair working conditions. It forms part of the EU policies and strategies relating to the promotion of decent work worldwide, including in global value chains, as referred to in the Commission Communication on decent work worldwide<sup>76</sup>.
- (4) The behaviour of companies across all sectors of the economy is key to success in the Union’s sustainability objectives as Union companies, especially large ones, rely on global value chains. It is also in the interest of companies to protect human rights and the environment, in particular given the rising concern of consumers and investors regarding these topics. Several initiatives fostering enterprises which support value-oriented transformation already exist on Union<sup>77</sup>, as well as national<sup>78</sup> level.
- (5) Existing international standards on responsible business conduct specify that companies should protect human rights and set out how they should address the protection of the environment across their operations and value chains. The United Nations Guiding Principles on Business and Human Rights<sup>79</sup> recognise the responsibility of companies to exercise human rights due diligence by identifying, preventing and mitigating the adverse impacts of their operations on human rights and by accounting for how they address those impacts. Those Guiding Principles state that businesses should avoid infringing human rights and should address adverse human rights impacts that they have caused, contributed to or are linked with in their own operations, subsidiaries and through their direct and indirect business relationships.
- (6) The concept of human rights due diligence was specified and further developed in the OECD Guidelines for Multinational Enterprises<sup>80</sup> which extended the application of due diligence to environmental and governance topics. The OECD Guidance on Responsible

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<sup>75</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – A Strong Social Europe for Just Transitions (COM/2020/14 final).

<sup>76</sup> Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on decent work worldwide for a global just transition and a sustainable recovery, COM(2022) 66 final.

<sup>77</sup> ‘Enterprise Models and the EU agenda’, *CEPS Policy Insights*, No PI2021-02/ January 2021.

<sup>78</sup> E.g. <https://www.economie.gouv.fr/entreprises/societe-mission>

<sup>79</sup> United Nations’ “Guiding Principles on Business and Human Rights: Implementing the United Nations ‘Protect, Respect and Remedy’ Framework”, 2011, available at [https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr\\_en.pdf](https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf).

<sup>80</sup> OECD Guidelines for Multinational Enterprises, 2011 updated edition, available at <http://mneguidelines.oecd.org/guidelines/>.

Business Conduct and sectoral guidance<sup>81</sup> are internationally recognised frameworks setting out practical due diligence steps to help companies identify, prevent, mitigate and account for how they address actual and potential impacts in their operations, value chains and other business relationships. The concept of due diligence is also embedded in the recommendations of the International Labour Organisation (ILO) Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy.<sup>82</sup>

- (7) The United Nations' Sustainable Development Goals<sup>83</sup>, adopted by all United Nations Member States in 2015, include the objectives to promote sustained, inclusive and sustainable economic growth. The Union has set itself the objective to deliver on the UN Sustainable Development Goals. The private sector contributes to those aims.
- (8) International agreements under the United Nations Framework Convention on Climate Change, to which the Union and the Member States are parties, such as the Paris Agreement<sup>84</sup> and the recent Glasgow Climate Pact<sup>85</sup>, set out precise avenues to address climate change and keep global warming within 1.5 C degrees. Besides specific actions being expected from all signatory Parties, the role of the private sector, in particular its investment strategies, is considered central to achieve these objectives.
- (9) In the European Climate Law<sup>86</sup>, the Union also legally committed to becoming climate-neutral by 2050 and to reducing emissions by at least 55% by 2030. Both these commitments require changing the way in which companies produce and procure. The Commission's 2030 Climate Target Plan<sup>87</sup> models various degrees of emission reductions required from different economic sectors, though all need to see considerable reductions under all scenarios for the Union to meet its climate objectives. The Plan also underlines that "changes in corporate governance rules and practices, including on sustainable finance, will make company owners and managers prioritise sustainability objectives in their actions and strategies." The 2019 Communication on the European Green Deal<sup>88</sup>

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<sup>81</sup> OECD Guidance on Responsible Business Conduct, 2018, and sector-specific guidance, available at <https://www.oecd.org/investment/due-diligence-guidance-for-responsible-business-conduct.htm>.

<sup>82</sup> The International Labour Organisation's "Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, Fifth Edition, 2017, available at: [https://www.ilo.org/empent/Publications/WCMS\\_094386/lang--en/index.htm](https://www.ilo.org/empent/Publications/WCMS_094386/lang--en/index.htm).

<sup>83</sup> [https://www.un.org/ga/search/view\\_doc.asp?symbol=A/RES/70/1&Lang=E](https://www.un.org/ga/search/view_doc.asp?symbol=A/RES/70/1&Lang=E).

<sup>84</sup> [https://unfccc.int/files/essential\\_background/convention/application/pdf/english\\_paris\\_agreement.pdf](https://unfccc.int/files/essential_background/convention/application/pdf/english_paris_agreement.pdf).

<sup>85</sup> Glasgow Climate Pact, adopted on 13 November 2021 at COP26 in Glasgow, [https://unfccc.int/sites/default/files/resource/cma2021\\_L16\\_adv.pdf](https://unfccc.int/sites/default/files/resource/cma2021_L16_adv.pdf), [https://unfccc.int/sites/default/files/resource/cma2021\\_L16\\_adv.pdf](https://unfccc.int/sites/default/files/resource/cma2021_L16_adv.pdf).

<sup>86</sup> Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law') PE/27/2021/REV/1 (OJ L 243, 9.7.2021, p. 1).

<sup>87</sup> SWD/2020/176 final.

<sup>88</sup> COM/2019/640 final.

sets out that all Union actions and policies should pull together to help the Union achieve a successful and just transition towards a sustainable future. It also sets out that sustainability should be further embedded into the corporate governance framework.

- (10) According to the Commission Communication on forging a climate-resilient Europe<sup>89</sup> presenting the Union Strategy on Adaptation to climate change, new investment and policy decisions should be climate-informed and future-proof, including for larger businesses managing value chains. This Directive should be consistent with that Strategy. Similarly, there should be consistency with the Commission Directive [...] amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, and environmental, social and governance risks (Capital Requirements Directive)<sup>90</sup>, which sets out clear requirements for banks' governance rules including knowledge about environmental, social and governance risks at board of directors level.
- (11) The Action Plan on a Circular Economy<sup>91</sup>, the Biodiversity strategy<sup>92</sup>, the Farm to Fork strategy<sup>93</sup> and the Chemicals strategy<sup>94</sup> and Updating the 2020 New Industrial Strategy: Building a stronger Single Market for Europe's recovery<sup>95</sup>, Industry 5.0<sup>96</sup> and the European Pillar of Social Rights Action Plan<sup>97</sup> and the 2021 Trade Policy Review<sup>98</sup> list an initiative on sustainable corporate governance among their elements.

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<sup>89</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Forging a climate-resilient Europe – the new EU Strategy on Adaptation to Climate Change (COM/2021/82 final), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2021:82:FIN>.

<sup>90</sup> OJ C [...], [...], p. [...].

<sup>91</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on A new Circular Economy Action Plan For a cleaner and more competitive Europe (COM/2020/98 final).

<sup>92</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the EU Biodiversity Strategy for 2030 Bringing nature back into our lives (COM/2020/380 final).

<sup>93</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on A Farm to Fork Strategy for a fair, healthy and environmentally-friendly food system (COM/2020/381 final).

<sup>94</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Chemicals Strategy for Sustainability Towards a Toxic-Free Environment (COM/2020/667 final).

<sup>95</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Updating the 2020 New Industrial Strategy: Building a stronger Single Market for Europe's recovery (COM/2021/350 final).

<sup>96</sup> Industry 5.0; [https://ec.europa.eu/info/research-and-innovation/research-area/industrial-research-and-innovation/industry-50\\_en](https://ec.europa.eu/info/research-and-innovation/research-area/industrial-research-and-innovation/industry-50_en)

<sup>97</sup> <https://op.europa.eu/webpub/empl/european-pillar-of-social-rights/en/>

- (12) This Directive is in coherence with the EU Action Plan on Human Rights and Democracy 2020-2024<sup>99</sup>. This Action Plan defines as a priority to strengthen the Union’s engagement to actively promote the global implementation of the United Nations Guiding Principles on Business and Human Rights and other relevant international guidelines such as the OECD Guidelines for Multinational Enterprises, including by advancing relevant due diligence standards.
- (13) The European Parliament, in its resolution of 10 March 2021 calls upon the Commission to propose Union rules for a comprehensive corporate due diligence obligation<sup>100</sup>. The Council Conclusions on Human Rights and Decent Work in Global Supply Chains of 1 December 2020 called upon the Commission to table a proposal for a Union legal framework on sustainable corporate governance, including cross-sector corporate due diligence obligations along global supply chains.<sup>101</sup> The European Parliament also calls for clarifying directors` duties in its own initiative report adopted on 2 December 2020 on sustainable corporate governance. In their Joint Declaration on EU Legislative Priorities for 2022<sup>102</sup>, the European Parliament, the Council of the European Union and the Commission have committed, to deliver on an economy that works for people, and to improve the regulatory framework on sustainable corporate governance.
- (14) This Directive aims to ensure that companies active in the internal market contribute to sustainable development and the sustainability transition of economies and societies through the identification, prevention and mitigation, bringing to an end and minimisation of potential or actual adverse human rights and environmental impacts connected with companies’ own operations, subsidiaries and value chains.
- (15) Companies should take appropriate steps to set up and carry out due diligence measures, with respect to their own operations, their subsidiaries, as well as their established direct and indirect business relationships throughout their value chains in accordance with the provisions of this Directive. This Directive should not require companies to guarantee, in all circumstances, that adverse impacts will never occur or that they will be stopped. For

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<sup>98</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Trade Policy Review – An Open, Sustainable and Assertive Trade Policy (COM/2021/66/final).

<sup>99</sup> Joint Communication to the European Parliament and the Council on the EU Action Plan on Human Rights and Democracy 2020-2024 (JOIN/2020/5 final).

<sup>100</sup> European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)), P9\_TA(2021)0073, available at [https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2020/2129\(INL\)](https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2020/2129(INL)).

<sup>101</sup> Council Conclusions on Human Rights and Decent Work in Global Supply Chains, 1 December 2020 (13512/20).

<sup>102</sup> Joint declaration of the European Parliament, the Council of the European Union and the European Commission on EU Legislative Priorities for 2022, available at [https://ec.europa.eu/info/sites/default/files/joint\\_declaration\\_2022.pdf](https://ec.europa.eu/info/sites/default/files/joint_declaration_2022.pdf).



example with respect to business relationships where the adverse impact results from State intervention, the company might not be in a position to arrive at such results. Therefore, the main obligations in this Directive should be ‘obligations of means’. The company should take the appropriate measures which can reasonably be expected to result in prevention or minimisation of the adverse impact under the circumstances of the specific case. Account should be taken of the specificities of the company’s value chain, sector or geographical area in which its value chain partners operate, the company’s power to influence its direct and indirect business relationships, and whether the company could increase its power of influence.

- (16) The due diligence process set out in this Directive should cover the six steps defined by the OECD Due Diligence Guidance for Responsible Business Conduct, which include due diligence measures for companies to identify and address adverse human rights and environmental impacts. This encompasses the following steps: (1) integrating due diligence into policies and management systems, (2) identifying and assessing adverse human rights and environmental impacts, (3) preventing, ceasing or minimising actual and potential adverse human rights, and environmental impacts, (4) assessing the effectiveness of measures, (5) communicating, (6) providing remediation.
- (17) Adverse human rights and environmental impact occur in companies’ own operations, subsidiaries, products, and in their value chains, in particular at the level of raw material sourcing, manufacturing, or at the level of product or waste disposal. In order for the due diligence to have a meaningful impact, it should cover human rights and environmental adverse impacts generated throughout the life-cycle of production and use and disposal of product or provision of services, at the level of own operations, subsidiaries and in value chains.
- (18) The value chain should cover activities related to the production of a good or 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 established business relationships of the company. It should encompass upstream established direct and indirect business relationships that design, extract, manufacture, transport, store and supply raw material, products, parts of products, or provide services to the company that are necessary to carry out the company’s activities, and also downstream relationships, including established direct and indirect business relationships, that use or receive products, parts of products or services from the company up to the end of life of the product, including inter alia the distribution of the product to retailers, the transport and storage of the product, dismantling of the product, its recycling, composting or landfilling.
- (19) As regards regulated financial undertakings providing loan, credit, or other financial services, “value chain” with respect to the provision of such services should be limited to the activities of the clients receiving such services, and the subsidiaries thereof whose activities are linked to the contract in question. Clients that are households and natural persons not acting in a professional or business capacity, as well as small and medium sized undertakings, should not be considered to be part of the value chain. The activities of the companies or other legal entities that are included in the value chain of that client should not be covered.

- (20) In order to allow companies to properly identify the adverse impacts in their value chain and to make it possible for them to exercise appropriate leverage, the due diligence obligations should be limited in this Directive to established business relationships. For the purpose of this Directive, established business relationships should mean such direct and indirect business relationships which are, or which are expected to be lasting, in view of their intensity and duration and which do not represent a negligible or ancillary part of the value chain. The nature of business relationships as “established” should be reassessed periodically, and at least every 12 months. If the direct business relationship of a company is established, then all linked indirect business relationships should also be considered as established regarding that company.
- (21) Under this Directive, EU companies with more than 500 employees on average and a worldwide net turnover exceeding EUR 150 million in the financial year preceding the last financial year should be required to comply with due diligence. As regards companies which do not fulfil those criteria, but which had more than 250 employees on average and more than EUR 40 million worldwide net turnover in the financial year preceding the last financial year and which operate in one or more high-impact sectors, due diligence should apply 2 years after the end of the transposition period of this directive, in order to provide for a longer adaptation period. In order to ensure a proportionate burden, companies operating in such high-impact sectors should be required to comply with more targeted due diligence focusing on severe adverse impacts. Temporary agency workers, including those posted under Article 1(3), point (c), of Directive 96/71/EC, as amended by Directive 2018/957/EU of the European Parliament and of the Council<sup>103</sup>, should be included in the calculation of the number of employees in the user company. Posted workers under Article 1(3), points (a) and (b), of Directive 96/71/EC, as amended by Directive 2018/957/EU, should only be included in the calculation of the number of employees of the sending company.
- (22) In order to reflect the priority areas of international action aimed at tackling human rights and environmental issues, the selection of high-impact sectors for the purposes of this Directive should be based on existing sectoral OECD due diligence guidance. The following sectors should be regarded as high-impact for the purposes of this Directive: the manufacture of textiles, leather and related products (including footwear), and the wholesale trade of textiles, clothing and footwear; agriculture, forestry, fisheries (including aquaculture), the manufacture of food products, and the wholesale trade of agricultural raw materials, live animals, wood, food, and beverages; the extraction of mineral resources regardless of where they are extracted from (including crude petroleum, natural gas, coal, lignite, metals and metal ores, as well as all other, non-

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<sup>103</sup> Directive (EU) 2018/957 of the European Parliament and of the Council of 28 June 2018 amending Directive 96/71/EC concerning the posting of workers in the framework of the provision of services (OJ L 173, 9.7.2018, p. 16).

metallic minerals and quarry products), the manufacture of basic metal products, other non-metallic mineral products and fabricated metal products (except machinery and equipment), and the wholesale trade of mineral resources, basic and intermediate mineral products (including metals and metal ores, construction materials, fuels, chemicals and other intermediate products). As regards the financial sector, due to its specificities, in particular as regards the value chain and the services offered, even if it is covered by sector-specific OECD guidance, it should not form part of the high-impact sectors covered by this Directive. At the same time, in this sector, the broader coverage of actual and potential adverse impacts should be ensured by also including very large companies in the scope that are regulated financial undertakings, even if they do not have a legal form with limited liability.

- (23) In order to achieve fully the objectives of this Directive addressing human rights and adverse environmental impacts with respect to companies' operations, subsidiaries and value chains, third-country companies with significant operations in the EU should also be covered. More specifically, the Directive should apply to third-country companies which generated a net turnover of at least EUR 150 million in the Union in the financial year preceding the last financial year or a net turnover of more than EUR 40 million but less than EUR 150 million in the financial year preceding the last financial year in one or more of the high-impact sectors, as of 2 years after the end of the transposition period of this Directive.
- (24) For defining the scope of application in relation to non-EU companies the described turnover criterion should be chosen as it creates a territorial connection between the third-country companies and the Union territory. Turnover is a proxy for the effects that the activities of those companies could have on the internal market. In accordance with international law, such effects justify the application of Union law to third-country companies. To ensure identification of the relevant turnover of companies concerned, the methods for calculating net turnover for non-EU companies as laid down in Directive (EU) 2013/34 as amended by Directive (EU) 2021/2101 should be used. To ensure effective enforcement of this Directive, an employee threshold should, in turn, not be applied to determine which third-country companies fall under this Directive, as the notion of "employees" retained for the purposes of this Directive is based on Union law and could not be easily transposed outside of the Union. In the absence of a clear and consistent methodology, including in accounting frameworks, to determine the employees of third-country companies, such employee threshold would therefore create legal uncertainty and would be difficult to apply for supervisory authorities. The definition of turnover should be based on Directive 2013/34/EU which has already established the methods for calculating net turnover for non-Union companies, as turnover and revenue definitions are similar in international accounting frameworks too. With a view to ensuring that the supervisory authority knows which third country companies generate the required turnover in the Union to fall under the scope of this Directive, this Directive should require that a supervisory authority in the Member State where the third country company's authorised representative is domiciled or established and, where it is different, a supervisory authority in the Member State in which the company generated most of its net turnover in the Union in the financial year preceding the last financial year are informed that the company is a company falling under the scope of this Directive.

- (25) In order to achieve a meaningful contribution to the sustainability transition, due diligence under this Directive should be carried out with respect to adverse human rights impact on protected persons resulting from the violation of one of the rights and prohibitions as enshrined in the international conventions as listed in the Annex to this Directive. In order to ensure a comprehensive coverage of human rights, a violation of a prohibition or right not specifically listed in that Annex which directly impairs a legal interest protected in those conventions should also form part of the adverse human rights impact covered by this Directive, provided that the company concerned could have reasonably established the risk of such impairment and any appropriate measures to be taken in order to comply with the due diligence obligations under this Directive, taking into account all relevant circumstances of their operations, such as the sector and operational context. Due diligence should further encompass adverse environmental impacts resulting from the violation of one of the prohibitions and obligations pursuant to the international environmental conventions listed in the Annex to this Directive.
- (26) Companies have guidance at their disposal that illustrates how their activities may impact human rights and which corporate behaviour is prohibited in accordance with internationally recognised human rights. Such guidance is included for instance in The United Nations Guiding Principles Reporting Framework<sup>104</sup> and the United Nations Guiding Principles Interpretative Guide<sup>105</sup>. Using relevant international guidelines and standards as a reference, the Commission should be able to issue additional guidance that will serve as a practical tool for companies.
- (27) In order to conduct appropriate human rights, and environmental due diligence with respect to their operations, their subsidiaries, and their value chains, companies covered by this Directive should integrate due diligence into corporate policies, identify, prevent and mitigate as well as bring to an end and minimise the extent of potential and actual adverse human rights and environmental impacts, establish and maintain a complaints procedure, monitor the effectiveness of the taken measures in accordance with the requirements that are set up in this Directive and communicate publicly on their due diligence. In order to ensure clarity for companies, in particular the steps of preventing and mitigating potential adverse impacts and of bringing to an end, or when this is not possible, minimising actual adverse impacts should be clearly distinguished in this Directive.
- (28) In order to ensure that due diligence forms part of companies' corporate policies, and in line with the relevant international framework, companies should integrate due diligence into all their corporate policies and have in place a due diligence policy. The due

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<sup>104</sup> [https://www.ungpreporting.org/wp-content/uploads/UNGPRreportingFramework\\_withguidance2017.pdf](https://www.ungpreporting.org/wp-content/uploads/UNGPRreportingFramework_withguidance2017.pdf).

<sup>105</sup> <https://www.ohchr.org/Documents/Issues/Business/RtRInterpretativeGuide.pdf>, <https://www.ohchr.org/Documents/Issues/Business/RtRInterpretativeGuide.pdf>.

diligence policy should contain a description of the company's approach, including in the long term, to due diligence, a code of conduct describing the rules and principles to be followed by the company's employees and subsidiaries; a description of the processes put in place to implement due diligence, including the measures taken to verify compliance with the code of conduct and to extend its application to established business relationships. The code of conduct should apply in all relevant corporate functions and operations, including procurement and purchasing decisions. Companies should also update their due diligence policy annually.

- (29) To comply with due diligence obligations, companies need to take appropriate measures with respect to identification, prevention and bringing to an end adverse impacts. An 'appropriate measure' should mean a measure that is capable of achieving the objectives of due diligence, commensurate with the degree of severity and the likelihood of the adverse impact, and reasonably available to the company, taking into account the circumstances of the specific case, including characteristics of the economic sector and of the specific business relationship and the company's influence thereof, and the need to ensure prioritisation of action. In this context, in line with international frameworks, the company's influence over a business relationship should include, on the one hand its ability to persuade the business relationship to take action to bring to an end or prevent adverse impacts (for example through ownership or factual control, market power, pre-qualification requirements, linking business incentives to human rights and environmental performance, etc.) and, on the other hand, the degree of influence or leverage that the company could reasonably exercise, for example through cooperation with the business partner in question or engagement with another company which is the direct business partner of the business relationship associated with adverse impact.
- (30) Under the due diligence obligations set out by this Directive, a company should identify actual or potential adverse human rights and environmental impacts. In order to allow for a comprehensive identification of adverse impacts, such identification should be based on quantitative and qualitative information. For instance, as regards adverse environmental impacts, the company should obtain information about baseline conditions at higher risk sites or facilities in value chains. Identification of adverse impacts should include assessing the human rights, and environmental context in a dynamic way and in regular intervals: prior to a new activity or relationship, prior to major decisions or changes in the operation; in response to or anticipation of changes in the operating environment; and periodically, at least every 12 months, throughout the life of an activity or relationship. Regulated financial undertakings providing loan, credit, or other financial services should identify the adverse impacts only at the inception of the contract. When identifying adverse impacts, companies should also identify and assess the impact of a business relationship's business model and strategies, including trading, procurement and pricing practices. Where the company cannot prevent, bring to an end or minimize all its adverse impacts at the same time, it should be able to prioritize its action, provided it takes the measures reasonably available to the company, taking into account the specific circumstances.

- (31) In order to avoid undue burden on the smaller companies operating in high-impact sectors which are covered by this Directive, those companies should only be obliged to identify those actual or potential severe adverse impacts that are relevant to the respective sector.
- (32) In line with international standards, prevention and mitigation as well as bringing to an end and minimisation of adverse impacts should take into account the interests of those adversely impacted. In order to enable continuous engagement with the value chain business partner instead of termination of business relations (disengagement) and possibly exacerbating adverse impacts, this Directive should ensure that disengagement is a last-resort action, in line with the Union's policy of zero-tolerance on child labour. Terminating a business relationship in which child labour was found could expose the child to even more severe adverse human rights impacts. This should therefore be taken into account when deciding on the appropriate action to take.
- (33) Under the due diligence obligations set out by this Directive, if a company identifies potential adverse human rights or environmental impacts, it should take appropriate measures to prevent and adequately mitigate them. To provide companies with legal clarity and certainty, this Directive should set out the actions companies should be expected to take for prevention and mitigation of potential adverse impacts where relevant depending on the circumstances.
- (34) So as to comply with the prevention and mitigation obligation under this Directive, companies should be required to take the following actions, where relevant. Where necessary due to the complexity of prevention measures, companies should develop and implement a prevention action plan. Companies should seek to obtain contractual assurances from a direct partner with whom they have an established business relationship that it will ensure compliance with the code of conduct or the prevention action plan, including by seeking corresponding contractual assurances from its partners to the extent that their activities are part of the companies' value chain. The contractual assurances should be accompanied by appropriate measures to verify compliance. To ensure comprehensive prevention of actual and potential adverse impacts, companies should also make investments which aim to prevent adverse impacts, provide targeted and proportionate support for an SME with which they have an established business relationship such as financing, for example, through direct financing, low-interest loans, guarantees of continued sourcing, and assistance in securing financing, to help implement the code of conduct or prevention action plan, or technical guidance such as in the form of training, management systems upgrading, and collaborate with other companies.
- (35) In order to reflect the full range of options for the company in cases where potential impacts could not be addressed by the described prevention or minimisation measures, this Directive should also refer to the possibility for the company to seek to conclude a contract with the indirect business partner, with a view to achieving compliance with the company's code of conduct or a prevention action plan, and conduct appropriate measures to verify compliance of the indirect business relationship with the contract.
- (36) In order to ensure that prevention and mitigation of potential adverse impacts is effective, companies should prioritize engagement with business relationships in the value chain, instead of terminating the business relationship, as a last resort action after attempting at preventing and mitigating adverse potential impacts without success. However, the

Directive should also, for cases where potential adverse impacts could not be addressed by the described prevention or mitigation measures, refer to the obligation for companies to refrain from entering into new or extending existing relations with the partner in question and, where the law governing their relations so entitles them to, to either temporarily suspend commercial relationships with the partner in question, while pursuing prevention and minimisation efforts, if there is reasonable expectation that these efforts are to succeed in the short-term; or to terminate the business relationship with respect to the activities concerned if the potential adverse impact is severe. In order to allow companies to fulfil that obligation, Member States should provide for the availability of an option to terminate the business relationship in contracts governed by their laws. It is possible that prevention of adverse impacts at the level of indirect business relationships requires collaboration with another company, for example a company which has a direct contractual relationship with the supplier. In some instances, such collaboration could be the only realistic way of preventing adverse impacts, in particular, where the indirect business relationship is not ready to enter into a contract with the company. In these instances, the company should collaborate with the entity which can most effectively prevent or mitigate adverse impacts at the level of the indirect business relationship while respecting competition law.

- (37) As regards direct and indirect business relationships, industry cooperation, industry schemes and multi-stakeholder initiatives can help create additional leverage to identify, mitigate, and prevent adverse impacts. Therefore it should be possible for companies to rely on such initiatives to support the implementation of their due diligence obligations laid down in this Directive to the extent that such schemes and initiatives are appropriate to support the fulfilment of those obligations. Companies could assess, at their own initiative, the alignment of these schemes and initiatives with the obligations under this Directive. In order to ensure full information on such initiatives, the Directive should also refer to the possibility for the Commission and the Member States to facilitate the dissemination of information on such schemes or initiatives and their outcomes. The Commission, in collaboration with Member States, may issue guidance for assessing the fitness of industry schemes and multi-stakeholder initiatives.
- (38) Under the due diligence obligations set out by this Directive, if a company identifies actual human rights or environmental adverse impacts, it should take appropriate measures to bring those to an end. It can be expected that a company is able to bring to an end actual adverse impacts in their own operations and in subsidiaries. However, it should be clarified that, as regards established business relationships, where adverse impacts cannot be brought to an end, companies should minimise the extent of such impacts. Minimisation of the extent of adverse impacts should require an outcome that is the closest possible to bringing the adverse impact to an end. To provide companies with legal clarity and certainty, this Directive should define which actions companies should be required to take for bringing actual human rights and environmental adverse impacts to an end and minimisation of their extent, where relevant depending on the circumstances.
- (39) So as to comply with the obligation of bringing to an end and minimising the extent of actual adverse impacts under this Directive, companies should be required to take the

following actions, where relevant. They should neutralise the adverse impact or minimise its extent, with an action proportionate to the significance and scale of the adverse impact and to the contribution of the company's conduct to the adverse impact. Where necessary due to the fact that the adverse impact cannot be immediately brought to an end, companies should develop and implement a corrective action plan with reasonable and clearly defined timelines for action and qualitative and quantitative indicators for measuring improvement. Companies should also seek to obtain contractual assurances from a direct business partner with whom they have an established business relationship that they will ensure compliance with the company's code of conduct and, as necessary, a prevention action plan, including by seeking corresponding contractual assurances from its partners, to the extent that their activities are part of the company's value chain. The contractual assurances should be accompanied by the appropriate measures to verify compliance. Finally, companies should also make investments aiming at ceasing or minimising the extent of adverse impact, provide targeted and proportionate support for an SMEs with which they have an established business relationship and collaborate with other entities, including, where relevant, to increase the company's ability to bring the adverse impact to an end.

- (40) In order to reflect the full range of options for the company in cases where actual impacts could not be addressed by the described measures, this Directive should also refer to the possibility for the company to seek to conclude a contract with the indirect business partner, with a view to achieving compliance with the company's code of conduct or a corrective action plan, and conduct appropriate measures to verify compliance of the indirect business relationship with the contract.
- (41) In order to ensure that bringing actual adverse impacts to an end or minimising them is effective, companies should prioritize engagement with business relationships in the value chain, instead of terminating the business relationship, as a last resort action after attempting at bringing actual adverse impacts to an end or minimising them without success. However, this Directive should also, for cases where actual adverse impacts could not be brought to an end or adequately mitigated by the described measures, refer to the obligation for companies to refrain from entering into new or extending existing relations with the partner in question and, where the law governing their relations so entitles them to, to either temporarily suspend commercial relationships with the partner in question, while pursuing efforts to bring to an end or minimise the extent of the adverse impact, or terminate the business relationship with respect to the activities concerned, if the adverse impact is considered severe. In order to allow companies to fulfil that obligation, Member States should provide for the availability of an option to terminate the business relationship in contracts governed by their laws.
- (42) Companies should provide the possibility for persons and organisations to submit complaints directly to them in case of legitimate concerns regarding actual or potential human rights and environmental adverse impacts. Organisations who could submit such complaints should include trade unions and other workers' representatives representing individuals working in the value chain concerned and civil society organisations active in the areas related to the value chain concerned where they have knowledge about a potential or actual adverse impact. Companies should establish a procedure for dealing



with those complaints and inform workers, trade unions and other workers' representatives, where relevant, about such processes. Recourse to the complaints and remediation mechanism should not prevent the complainant from having recourse to judicial remedies. In accordance with international standards, complaints should be entitled to request from the company appropriate follow-up on the complaint and to meet with the company's representatives at an appropriate level to discuss potential or actual severe adverse impacts that are the subject matter of the complaint. This access should not lead to unreasonable solicitations of companies.

- (43) Companies should monitor the implementation and effectiveness of their due diligence measures. They should carry out periodic assessments of their own operations, those of their subsidiaries and, where related to the value chains of the company, those of their established business relationships, to monitor the effectiveness of the identification, prevention, minimisation, bringing to an end and mitigation of human rights and environmental adverse impacts. Such assessments should verify that adverse impacts are properly identified, due diligence measures are implemented and adverse impacts have actually been prevented or brought to an end. In order to ensure that such assessments are up-to-date, they should be carried out at least every 12 months and be revised in-between if there are reasonable grounds to believe that significant new risks of adverse impact could have arisen.
- (44) Like in the existing international standards set by the United Nations Guiding Principles on Business and Human Rights and the OECD framework, it forms part of the due diligence requirement to communicate externally relevant information on due diligence policies, processes and activities conducted to identify and address actual or potential adverse impacts, including the findings and outcomes of those activities. The proposal to amend Directive 2013/34/EU as regards corporate sustainability reporting sets out relevant reporting obligations for the companies covered by this directive. In order to avoid duplicating reporting obligations, this Directive should therefore not introduce any new reporting obligations in addition to those under Directive 2013/34/EU for the companies covered by that Directive as well as the reporting standards that should be developed under it. As regards companies that are within the scope of this Directive, but do not fall under Directive 2013/34/EU, in order to comply with their obligation of communicating as part of the due diligence under this Directive, they should publish on their website an annual statement in a language customary in the sphere of international business.
- (45) In order to facilitate companies' compliance with their due diligence requirements through their value chain and limiting shifting compliance burden on SME business partners, the Commission should provide guidance on model contractual clauses.
- (46) In order to provide support and practical tools to companies or to Member State authorities on how companies should fulfil their due diligence obligations, the Commission, using relevant international guidelines and standards as a reference, and in consultation with Member States and stakeholders, the European Union Agency for Fundamental Rights, the European Environment Agency, and where appropriate with international bodies having expertise in due diligence, should have the possibility to issue guidelines, including for specific sectors or specific adverse impacts.

- (47) Although SMEs are not included in the scope of this Directive, they could be impacted by its provisions as contractors or subcontractors to the companies which are in the scope. The aim is nevertheless to mitigate financial or administrative burden on SMEs, many of which are already struggling in the context of the global economic and sanitary crisis. In order to support SMEs, Member States should set up and operate, either individually or jointly, dedicated websites, portals or platforms, and Member States could also financially support SMEs and help them build capacity. Such support should also be made accessible, and where necessary adapted and extended to upstream economic operators in third countries. Companies whose business partner is an SME, are also encouraged to support them to comply with due diligence measures, in case such requirements would jeopardize the viability of the SME and use fair, reasonable, non-discriminatory and proportionate requirements vis-a-vis the SMEs.
- (48) In order to complement Member State support to SMEs, the Commission may build on existing EU tools, projects and other actions helping with the due diligence implementation in the EU and in third countries. It may set up new support measures that provide help to companies, including SMEs on due diligence requirements, including an observatory for value chain transparency and the facilitation of joint stakeholder initiatives.
- (49) The Commission and Member States should continue to work in partnership with third countries to support upstream economic operators build the capacity to effectively prevent and mitigate adverse human rights and environmental impacts of their operations and business relationships, paying specific attention to the challenges faced by smallholders. They should use their neighbourhood, development and international cooperation instruments to support third country governments and upstream economic operators in third countries addressing adverse human rights and environmental impacts of their operations and upstream business relationships. This could include working with partner country governments, the local private sector and stakeholders on addressing the root causes of adverse human rights and environmental impacts.
- (50) In order to ensure that this Directive effectively contributes to combating climate change, companies should 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. In case climate is or should have been identified as a principal risk for or a principal impact of the company's operations, the company should include emissions reduction objectives in its plan.
- (51) With a view to ensure that such emission reduction plan is properly implemented and embedded in the financial incentives of directors, the plan should be duly taken into account when setting directors' variable remuneration, if variable remuneration is linked to the contribution of a director to the company's business strategy and long-term interests and sustainability.
- (52) In order to allow for the effective oversight of and, where necessary, enforcement of this Directive in relation to those companies that are not governed by the law of a Member State, those companies should designate a sufficiently mandated authorised representative in the Union and provide information relating to their authorised representatives. It

should be possible for the authorised representative to also function as point of contact, provided the relevant requirements of this Directive are complied with.

- (53) In order to ensure the monitoring of the correct implementation of companies' due diligence obligations and ensure the proper enforcement of this Directive, Member States should designate one or more national supervisory authorities. These supervisory authorities should be of a public nature, independent from the companies falling within the scope of this Directive or other market interests, and free of conflicts of interest. In accordance with national law, Member States should ensure appropriate financing of the competent authority. They should be entitled to carry out investigations, on their own initiative or based on complaints or substantiated concerns raised under this Directive. Where competent authorities under sectoral legislation exist, Member States could identify those as responsible for the application of this Directive in their areas of competence. They could designate authorities for the supervision of regulated financial undertaking also as supervisory authorities for the purposes of this Directive.
- (54) In order to ensure effective enforcement of national measures implementing this Directive, Member States should provide for dissuasive, proportionate and effective sanctions for infringements of those measures. In order for such sanction regime to be effective, administrative sanctions to be imposed by the national supervisory authorities should include pecuniary sanctions. Where the legal system of a Member State does not provide for administrative sanctions as foreseen in this Directive, the rules on administrative sanctions should be applied in such a way that the sanction is initiated by the competent supervisory authority and imposed by the judicial authority. Therefore, it is necessary that those Member States ensure that the application of the rules and sanctions has an equivalent effect to the administrative sanctions imposed by the competent supervisory authorities.
- (55) In order to ensure consistent application and enforcement of national provisions adopted pursuant to this Directive, national supervisory authorities should cooperate and coordinate their action. For that purpose a European Network of Supervisory Authorities should be set up by the Commission and the supervisory authorities should assist each other in performing their tasks and provide mutual assistance.
- (56) In order to ensure effective compensation of victims of adverse impacts, Member States should be required to lay down rules governing the civil liability of companies for damages arising due to its failure to comply with the due diligence process. The company should be liable for damages if they failed to comply with the obligations to prevent and mitigate potential adverse impacts or to bring actual impacts to an end and minimise their extent, and as a result of this failure an adverse impact that should have been identified, prevented, mitigated, brought to an end or its extent minimised through the appropriate measures occurred and led to damage.
- (57) As regards damages occurring at the level of established indirect business relationships, the liability of the company should be subject to specific conditions. The company should not be liable if it carried out specific due diligence measures. However, it should not be exonerated from liability through implementing such measures in case it was unreasonable to expect that the action actually taken, including as regards verifying compliance, would be adequate to prevent, mitigate, bring to an end or minimise the

adverse impact. In addition, in the assessment of the existence and extent of liability, due account is to be taken of the company's efforts, insofar as they relate directly to the damage in question, to comply with any remedial action required of them by a supervisory authority, any investments made and any targeted support provided as well as any collaboration with other entities to address adverse impacts in its value chains.

- (58) The liability regime does not regulate who should prove that the company's action was reasonably adequate under the circumstances of the case, therefore this question is left to national law.
- (59) As regards civil liability rules, the civil liability of a company for damages arising due to its failure to carry out adequate due diligence should be without prejudice to civil liability of its subsidiaries or the respective civil liability of direct and indirect business partners in the value chain. Also, the civil liability rules under this Directive should be without prejudice to 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 than this Directive.
- (60) As regards civil liability arising from adverse environmental impacts, persons who suffer damage can claim compensation under this Directive even where they overlap with human rights claims.
- (61) In order to ensure that victims of human rights and environmental harms can bring an action for damages and claim compensation for damages arising due to a company's failure to comply with the due diligence obligations stemming from this Directive, even where the law applicable to such claims is not the law of a Member State, as could be for instance be the case in accordance with international private law rules when the damage occurs in a third country, this Directive should require Member States to ensure that the liability provided for in provisions of national law transposing this Article is of overriding mandatory application in cases where the law applicable to claims to that effect is not the law of a Member State.
- (62) The civil liability regime under this Directive should be without prejudice to the Environmental Liability Directive 2004/35/EC. This Directive should not prevent Member States from imposing further, more stringent obligations on companies or from otherwise taking further measures having the same objectives as that Directive.
- (63) In all Member States' national laws, directors owe a duty of care to the company. In order to ensure that this general duty is understood and applied in a manner which is coherent and consistent with the due diligence obligations introduced by this Directive and that directors systematically take into account sustainability matters in their decisions, this Directive should clarify, in a harmonised manner, the general duty of care of directors to act in the best interest of the company, by laying down that directors take into account the sustainability matters as referred to in Directive 2013/34/EU, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term horizons. Such clarification does not require changing existing national corporate structures.
- (64) Responsibility for due diligence should be assigned to the company's directors, in line with the international due diligence frameworks. Directors should therefore be

responsible for putting in place and overseeing the due diligence actions as laid down in this Directive and for adopting the company's due diligence policy, taking into account the input of stakeholders and civil society organisations and integrating due diligence into corporate management systems. Directors should also adapt the corporate strategy to actual and potential impacts identified and any due diligence measures taken.

- (65) Persons who work for companies subject to due diligence obligations under this Directive or who are in contact with such companies in the context of their work-related activities can play a key role in exposing breaches of the rules of this Directive. They can thus contribute to preventing and deterring such breaches and strengthening the enforcement of this Directive. Directive (EU) 2019/1937 of the European Parliament and of the Council<sup>106</sup> should therefore apply to the reporting of all breaches of this Directive and to the protection of persons reporting such breaches.
- (66) In order to specify the information that companies not subject to reporting requirements under the provisions on corporate sustainability reporting under Directive 2013/34/EU should be communicating on the matters covered by this Directive, the power to adopt acts in accordance with Article 290 of the Treaty on the Functioning of the European Union should be delegated to the Commission in respect of determining additional rules concerning the content and criteria of such reporting, specifying information on the description of due diligence, potential and actual impacts and actions taken on those. It is of particular importance that the Commission carry out appropriate consultations during its preparatory work, including at expert level, and that those consultations be conducted in accordance with the principles laid down in the Interinstitutional Agreement of 13 April 2016 on Better Law-Making<sup>107</sup>. In particular, to ensure equal participation in the preparation of delegated acts, the European Parliament and the Council receive all documents at the same time as Member States' experts, and their experts systematically have access to meetings of Commission expert groups dealing with the preparation of delegated acts.
- (67) This Directive should be applied in compliance with Union data protection law and the right to the protection of privacy and personal data as enshrined in Articles 7 and 8 of the Charter of Fundamental Rights of the European Union. Any processing of personal data under this Directive is to be undertaken in accordance with Regulation (EU) 2016/679 of the European Parliament and of the Council<sup>108</sup>, including the requirements of purpose limitation, data minimisation and storage limitation.

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<sup>106</sup> Directive (EU) 2019/1937 of the European Parliament and of the Council of 23 October 2019 on the protection of persons who report breaches of Union law (OJ L 305, 26.11.2019, p. 17).

<sup>107</sup> OJ L 123, 12.5.2016, p. 1.

<sup>108</sup> Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of

- (68) The European Data Protection Supervisor was consulted in accordance with Article 28(2) of Regulation (EU) 2018/1725 of the European Parliament and of the Council<sup>109</sup> and delivered an opinion on ... 2022.
- (69) This Directive is without prejudice to obligations in the areas of human rights, protection of the environment and climate change under other Union legislative acts. If the provisions of this Directive conflict with a provision of another Union legislative act pursuing the same objectives and providing for more extensive or more specific obligations, the provisions of the other Union legislative act should prevail to the extent of the conflict and shall apply to those specific obligations.
- (70) The Commission should assess and report whether new sectors should be added to the list of high-impact sectors covered by this Directive, in order to align it to guidance from the Organisation for Economic Cooperation and Development or in light of clear evidence on labour exploitation, human rights violations or newly emerging environmental threats, whether the list of relevant international conventions referred to in this Directive should be amended, in particular in the light of international developments, or whether the provisions on due diligence under this Directive should be extended to adverse climate impacts.
- (71) The objective of this Directive, namely better exploiting the potential of the single market to contribute to the transition to a sustainable economy and contributing to sustainable development through the prevention and mitigation of potential or actual human rights and environmental adverse impacts in companies' value chains, cannot be sufficiently achieved by the Member States acting individually or in an uncoordinated manner, but can rather, by reason of the scale and effects of the actions, be better achieved at Union level. In particular, addressed problems and their causes are of a transnational dimension, as many companies are operating Union wide or globally and value chains expand to other Member States and to third countries. Moreover, individual Member States' measures risk being ineffective and lead to fragmentation of the internal market. Therefore, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 TEU. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve that objective.

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such data, and repealing Directive 95/46/EC (General Data Protection Regulation) OJ L 119, 4.5.2016, p. 1–88.

<sup>109</sup> Regulation (EU) 2018/1725 of the European Parliament and of the Council of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data (OJ L 295, 21.11.2018, p. 39).

HAVE ADOPTED THIS DIRECTIVE:

### *Article 1*

#### **Subject matter**

1. This Directive lays down rules
  - (a) on obligations for companies regarding actual and potential human rights adverse impacts and environmental adverse impacts, with respect to their own operations, the operations of their subsidiaries, and the value chain operations carried out by entities with whom the company has an established business relationship and
  - (b) on liability for violations of the obligations mentioned above.

The nature of business relationships as ‘established’ shall be reassessed periodically, and at least every 12 months.
2. This Directive shall not constitute grounds for reducing the level of protection of human rights or of protection of the environment or the protection of the climate provided for by the law of Member States at the time of the adoption of this Directive.
3. This Directive shall be without prejudice to obligations in the areas of human rights, protection of the environment and climate change under other Union legislative acts. If the provisions of this Directive conflict with a provision of another Union legislative act pursuing the same objectives and providing for more extensive or more specific obligations, the provisions of the other Union legislative act shall prevail to the extent of the conflict and shall apply to those specific obligations.

### *Article 2*

#### **Scope**

1. This Directive shall apply to companies which are formed in accordance with the legislation of a Member State and which fulfil one of the following conditions:
  - (a) the company had more than 500 employees on average and had a net worldwide turnover of more than EUR 150 million in the last financial year for which annual financial statements have been prepared;
  - (b) the company did not reach the thresholds under point (a), but had more than 250 employees on average and had a net worldwide turnover of more than EUR 40 million in the last financial year for which annual financial statements have been prepared, provided that at least 50% of this net turnover was generated in one or more of the following sectors:
    - (i) the manufacture of textiles, leather and related products (including footwear), and the wholesale trade of textiles, clothing and footwear;

- (ii) agriculture, forestry, fisheries (including aquaculture), the manufacture of food products, and the wholesale trade of agricultural raw materials, live animals, wood, food, and beverages;
  - (iii) the extraction of mineral resources regardless from where they are extracted (including crude petroleum, natural gas, coal, lignite, metals and metal ores, as well as all other, non-metallic minerals and quarry products), the manufacture of basic metal products, other non-metallic mineral products and fabricated metal products (except machinery and equipment), and the wholesale trade of mineral resources, basic and intermediate mineral products (including metals and metal ores, construction materials, fuels, chemicals and other intermediate products).
- 2. This Directive shall also apply to companies which are formed in accordance with the legislation of a third country, and fulfil one of the following conditions:
  - (a) generated a net turnover of more than EUR 150 million in the Union in the financial year preceding the last financial year;
  - (b) generated a net turnover of more than EUR 40 million but not more than EUR 150 million in the Union in the financial year preceding the last financial year, provided that at least 50% of its net worldwide turnover was generated in one or more of the sectors listed in paragraph 1, point (b).
- 3. For the purposes of paragraph 1, the number of part-time employees shall be calculated on a full-time equivalent basis. Temporary agency workers shall be included in the calculation of the number of employees in the same way as if they were workers employed directly for the same period of time by the company.
- 4. As regards the companies referred to in paragraph 1, the Member State competent to regulate matters covered in this Directive shall be the Member State in which the company has its registered office.

### *Article 3*

#### **Definitions**

For the purpose of this Directive, the following definitions shall apply:

- (a) 'company' means any of the following:



- (i) a legal person constituted as one of the legal forms listed in Annex I to Directive 2013/34/EU of the European Parliament and of the Council<sup>110</sup>;
- (ii) a legal person constituted in accordance with the law of a third country in a form comparable to those listed in Annex I and II of that Directive;
- (iii) a legal person constituted as one of the legal forms listed in Annex II to Directive 2013/34/EU composed entirely of undertakings organised in one of the legal forms falling within points (i) and (ii);
- (iv) a regulated financial undertaking, regardless of its legal form, which is
  - a credit institution as defined in Article 4(1), point (1), of Regulation (EU) No 575/2013 of the European Parliament and of the Council<sup>111</sup>;
  - an investment firm as defined in Article 4(1), point (1), of Directive 2014/65/EU of the European Parliament and of the Council<sup>112</sup>;
  - an alternative investment fund manager (AIFM) as defined in Article 4(1), point (b), of Directive 2011/61/EU of the European Parliament and of the Council (2), including a manager of Euveca under Regulation (EU) No 345/2013 of the European Parliament and of the Council<sup>113</sup>, a manager of EuSEF under Regulation (EU) No 346/2013 of the European Parliament and of the Council<sup>114</sup> and a manager of ELTIF under Regulation (EU) 2015/760 of the European Parliament and of the Council<sup>115</sup>;

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<sup>110</sup> Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings (OJ L 182, 29.6.2013, p. 19).

<sup>111</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

<sup>112</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349).

<sup>113</sup> Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds (OJ L 115, 25.4.2013, p. 1).

<sup>114</sup> Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds (OJ L 115, 25.4.2013, p. 18).

<sup>115</sup> Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds (OJ L 123, 19.5.2015, p. 98).

- an undertaking for collective investment in transferable securities (UCITS) management company as defined Article 2(1), point (b), of Directive 2009/65/EC of the European Parliament and of the Council<sup>116</sup>;
- an insurance undertaking as defined in Article 13, point (1), of Directive 2009/138/EC of the European Parliament and of the Council<sup>117</sup>;
- a reinsurance undertaking as defined in Article 13, point (4), of Directive 2009/138/EC;
- an institution for occupational retirement provision as defined in Article 1, point (6) of Directive 2016/2341 of the European Parliament and of the Council<sup>118</sup>;
- pension institutions operating pension schemes which are considered to be social security schemes covered by Regulation (EC) No 883/2004 of the European Parliament and of the Council<sup>119</sup> and Regulation (EC) No 987/2009 of the European Parliament and of the Council<sup>120</sup> as well as any legal entity set up for the purpose of investment of such schemes;
- an alternative investment fund (AIF) managed by an AIFM as defined in Article 4(1), point (b), of Directive 2011/61/EU or an AIF supervised under the applicable national law;
- UCITS in the meaning of Article 1(2) of Directive 2009/65/EC;
- a central counterparty as defined in Article 2, point (1), of Regulation (EU) No 648/2012 of the European Parliament and of the Council<sup>121</sup>;

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<sup>116</sup> Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 302, 17.11.2009, p. 32).

<sup>117</sup> Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 335, 17.12.2009, p. 1).

<sup>118</sup> Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (OJ L 354, 23.12.2016, p. 37).

<sup>119</sup> Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems (OJ L 166, 30.4.2004, p. 1).

<sup>120</sup> Regulation (EC) No 987/2009 of the European Parliament and of the Council of 16 September 2009 laying down the procedure for implementing Regulation (EC) No 883/2004 on the coordination of social security systems (OJ L 284, 30.10.2009, p. 1).

<sup>121</sup> Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1).

- a central securities depository as defined in Article 2(1), point (1), of Regulation (EU) No 909/2014 of the European Parliament and of the Council<sup>122</sup>;
- an insurance or reinsurance special purpose vehicle authorised in accordance with Article 211 of Directive 2009/138/EC;
- ‘securitisation special purpose entity’ as defined in Article 2, point (2), of Regulation (EU) No 2017/2402 of the European Parliament and of the Council<sup>123</sup>;
- an insurance holding company as defined in Article 212(1), point (f), of Directive 2009/138/EC or a mixed financial holding company as defined in Article 212(1), point (h), of Directive 2009/138/EC, which is part of an insurance group that is subject to supervision at the level of the group pursuant to Article 213 of that Directive and which is not exempted from group supervision pursuant to Article 214(2) of Directive 2009/138/EC;
- a payment institution as defined in point (d) of Article 1(1) of Directive (EU) 2015/2366 of the European Parliament and of the Council<sup>124</sup>;
- an electronic money institution as defined in point (1) of Article 2 of Directive 2009/110/EC of the European Parliament and of the Council<sup>125</sup>;
- a crowdfunding service provider as defined in point (e) Article 2(1) of Regulation (EU) 2020/1503 of the European Parliament and of the Council<sup>126</sup>;
- a crypto-asset service provider as defined in Article 3(1), point (8), of [the proposal for a Regulation of the European Parliament and of the Council on

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<sup>122</sup> Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (OJ L 257, 28.8.2014, p. 1).

<sup>123</sup> Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (OJ L 347, 28.12.2017, p. 35).

<sup>124</sup> Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (OJ L 337, 23.12.2015, p. 35).

<sup>125</sup> Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC (OJ L 267, 10.10.2009, p. 7).

<sup>126</sup> Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937 (OJ L 347, 20.10.2020, p. 1).

Markets in Crypto-assets, and amending Directive (EU) 2019/1937<sup>127]</sup> where performing one or more crypto-asset services as defined in Article 3(1), point (9), of [the proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937];

- (b) ‘adverse environmental impact’ means an adverse impact on the environment resulting from the violation of one of the prohibitions and obligations pursuant to the international environmental conventions listed in the Annex, Part II;
- (c) ‘adverse human rights impact’ means an adverse impact on protected persons resulting from the violation of one of the rights or prohibitions listed in the Annex, Part I Section 1, as enshrined in the international conventions listed in the Annex, Part I Section 2;
- (d) ‘subsidiary’ means a legal person through which the activity of a ‘controlled undertaking’ as defined in Article 2(1), point (f), of Directive 2004/109/EC of the European Parliament and of the Council<sup>128</sup> is exercised;
- (e) ‘business relationship’ means a relationship with a contractor, subcontractor or any other legal entities (‘partner’)
  - (i) with whom the company has a commercial agreement or to whom the company provides financing, insurance or reinsurance, or
  - (ii) that performs business operations related to the products or services of the company for or on behalf of the company;
- (f) ‘established business relationship’ means a business relationship, whether direct or indirect, which is, or which is expected to be lasting, in view of its intensity or duration and which does not represent a negligible or merely ancillary part of the value chain;
- (g) ‘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. As regards companies within the meaning of point (a)(iv), ‘value chain’ with respect to the provision of these specific services shall only include the activities of the clients receiving such loan, credit, and other financial services and of other companies belonging to the same group whose activities are linked to the contract in question. The value chain of such regulated

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<sup>127</sup> COM/2020/593 final.

<sup>128</sup> Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ L 390, 31.12.2004, p. 38).

financial undertakings does not cover SMEs receiving loan, credit, financing, insurance or reinsurance of such entities;

- (h) ‘independent third-party verification’ means verification of the compliance by a company, or parts of its value chain, with human rights and environmental requirements resulting from the provisions of this Directive by an auditor which is independent from the company, free from any conflicts of interests, has experience and competence in environmental and human rights matters and is accountable for the quality and reliability of the audit;
- (i) ‘SME’ means a micro, small or a medium-sized enterprise, irrespective of its legal form, that is not part of a large group, as those terms are defined in Article 3(1), (2), (3) and (7) of Directive 2013/34/EU;
- (j) ‘industry initiative’ means a combination of voluntary value chain due diligence procedures, tools and mechanisms, including independent third-party verifications, developed and overseen by governments, industry associations or groupings of interested organisations;
- (k) ‘authorised representative’ means a natural or legal person resident or established in the Union who has a mandate from a company within the meaning of point (a)(ii) to act on its behalf in relation to compliance with that company’s obligations pursuant to this Directive;
- (l) ‘severe adverse impact’ means an adverse environmental impact or an adverse human rights impact that is especially significant by its nature, or affects a large number of persons or a large area of the environment, or which is irreversible, or is particularly difficult to remedy as a result of the measures necessary to restore the situation prevailing prior to the impact;
- (m) ‘net turnover’ means
  - (i) the ‘net turnover’ as defined in Article 2, point (5), of Directive 2013/34/EU; or,
  - (ii) where the company applies international accounting standards adopted on the basis of Regulation (EC) No 1606/2002 of the European Parliament and of the Council<sup>129</sup> or is a company within the meaning of point (a)(ii), the revenue as defined by or within the meaning of the financial reporting framework on the basis of which the financial statements of the company are prepared;
- (n) ‘stakeholders’ means the company’s employees, the employees of its subsidiaries, and other individuals, groups, communities or entities whose rights or interests are or could

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<sup>129</sup> Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ L 243, 11.9.2002, p.1).

be affected by the products, services and operations of that company, its subsidiaries and its business relationships;

- (o) ‘director’ means:
  - (i) any member of the administrative, management or supervisory bodies of a company;
  - (ii) where they are not members of the administrative, management or supervisory bodies of a company, the chief executive officer and, if such function exists in a company, the deputy chief executive officer;
  - (iii) other persons who perform functions similar to those performed under point (i) or (ii);
- (p) ‘board of directors’ means the administrative or supervisory body responsible for supervising the executive management of the company, or, if no such body exists, the person or persons performing equivalent functions;
- (q) ‘appropriate measure’ means a measure that is capable of achieving the objectives of due diligence, commensurate with the degree of severity and the likelihood of the adverse impact, and reasonably available to the company, taking into account the circumstances of the specific case, including characteristics of the economic sector and of the specific business relationship and the company’s influence thereof, and the need to ensure prioritisation of action.

#### *Article 4*

#### **Due diligence**

1. Member States shall ensure that companies conduct human rights and environmental due diligence as laid down in Articles 5 to 11 (‘due diligence’) by carrying out the following actions:
  - (a) integrating due diligence into their policies in accordance with Article 5;
  - (b) identifying actual or potential adverse impacts in accordance with Article 6;
  - (c) preventing and mitigating potential adverse impacts, and bringing actual adverse impacts to an end and minimising their extent in accordance with Articles 7 and 8;
  - (d) establishing and maintaining a complaints procedure in accordance with Article 9;
  - (e) monitoring the effectiveness of their due diligence policy and measures in accordance with Article 10;
  - (f) publicly communicating on due diligence in accordance with Article 11.
2. Member States shall ensure that, for the purposes of due diligence, companies are entitled to share resources and information within their respective groups of companies and with other legal entities in compliance with applicable competition law.

## *Article 5*

### **Integrating due diligence into companies' policies**

1. Member States shall ensure that companies integrate due diligence into all their corporate policies and have in place a due diligence policy. The due diligence policy shall contain all of the following:
  - (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, including the measures taken to verify compliance with the code of conduct and to extend its application to established business relationships.
2. Member States shall ensure that the companies update their due diligence policy annually.

## *Article 6*

### **Identifying actual and potential adverse impacts**

1. Member States shall ensure that companies take appropriate measures to identify actual and potential adverse human rights impacts and adverse environmental impacts arising from their own operations or those of their subsidiaries and, where related to their value chains, from their established business relationships, in accordance with paragraph 2, 3 and 4.
2. By way of derogation from paragraph 1, companies referred to in Article 2(1), point (b), and Article 2(2), point (b), shall only be required to identify actual and potential severe adverse impacts relevant to the respective sector mentioned in Article 2(1), point (b).
3. When companies referred to in Article 3, point (a)(iv), provide credit, loan or other financial services, identification of actual and potential adverse human rights impacts and adverse environmental impacts shall be carried out only before providing that service..
4. Member States shall ensure that, for the purposes of identifying the adverse impacts referred to in paragraph 1 based on, where appropriate, quantitative and qualitative information, companies are entitled to make use of appropriate resources, including independent reports and information gathered through the complaints procedure provided for in Article 9. Companies shall, where relevant, also carry out consultations with potentially affected groups including workers and other relevant stakeholders to gather information on actual or potential adverse impacts.

## Article 7

### Preventing potential adverse impacts

1. Member States shall ensure that companies take appropriate measures to prevent, or where prevention is not possible or not immediately possible, adequately mitigate potential adverse human rights impacts and adverse environmental impacts that have been, or should have been, identified pursuant to Article 6, in accordance with paragraphs 2, 3, 4 and 5 of this Article.
2. Companies shall be required to take the following actions, where relevant:
  - (a) where necessary due to the nature or complexity of the measures required for prevention, develop and implement a prevention action plan, with reasonable and clearly defined timelines for action and qualitative and quantitative indicators for measuring improvement. The prevention action plan shall be developed in consultation with affected stakeholders;
  - (b) seek contractual assurances from a business partner with whom it has a direct business relationship that it will ensure compliance with the company's code of conduct and, as necessary, a prevention action plan, including by seeking corresponding contractual assurances from its partners, to the extent that their activities are part of the company's value chain (contractual cascading). When such contractual assurances are obtained, paragraph 4 shall apply;
  - (c) make necessary investments, such as into management or production processes and infrastructures, to comply with paragraph 1;
  - (d) provide targeted and proportionate support for an SME with which the company has an established business relationship, where compliance with the code of conduct or the prevention action plan would jeopardise the viability of the SME;
  - (e) in compliance with Union law including competition law, collaborate with other entities, including, where relevant, to increase the company's ability to bring the adverse impact to an end, in particular where no other action is suitable or effective.
3. As regards potential adverse impacts that could not be prevented or adequately mitigated by the measures in paragraph 2, the company may seek to conclude a contract with a partner with whom it has an indirect relationship, with a view to achieving compliance with the company's code of conduct or a prevention action plan. When such a contract is concluded, paragraph 4 shall apply.
4. The contractual assurances or the contract shall be accompanied by the appropriate measures to verify compliance. For the purposes of verifying compliance, the company may refer to suitable industry initiatives or independent third-party verification.

When contractual assurances are obtained from, or a contract is entered into, with an SME, the terms used shall be fair, reasonable and non-discriminatory. Where measures to verify compliance are carried out in relation to SMEs, the company shall bear the cost of the independent third-party verification.



5. As regards potential adverse impacts within the meaning of paragraph 1 that could not be prevented or adequately mitigated by the measures in paragraphs 2, 3 and 4, the company shall be required to refrain from entering into new or extending existing relations with the partner in connection with or in the value chain of which the impact has arisen and shall, where the law governing their relations so entitles them to, take the following actions:
  - (a) temporarily suspend commercial relations with the partner in question, while pursuing prevention and minimisation efforts, if there is reasonable expectation that these efforts will succeed in the short-term;
  - (b) terminate the business relationship with respect to the activities concerned if the potential adverse impact is severe.Member States shall provide for the availability of an option to terminate the business relationship in contracts governed by their laws.
6. By way of derogation from paragraph 5, point (b), when companies referred to in Article 3, point (a)(iv), provide credit, loan or other financial services, they shall not be required to terminate the credit, loan or other financial service contract when this can be reasonably expected to cause substantial prejudice to the entity to whom that service is being provided.

#### *Article 8*

##### **Bringing actual adverse impacts to an end**

1. Member States shall ensure that companies take appropriate measures to bring actual adverse impacts that have been, or should have been, identified pursuant to Article 6 to an end, in accordance with paragraphs 2 to 6 of this Article.
2. Where the adverse impact cannot be brought to an end, Member States shall ensure that companies minimise the extent of such an impact.
3. Companies shall be required to take the following actions, where relevant:
  - (a) neutralise the adverse impact or minimise its extent, including by the payment of damages to the affected persons and of financial compensation to the affected communities. The action shall be proportionate to the significance and scale of the adverse impact and to the contribution of the company's conduct to the adverse impact;
  - (b) where necessary due to the fact that the adverse impact cannot be immediately brought to an end, develop and implement a corrective action plan with reasonable and clearly defined timelines for action and qualitative and quantitative indicators for measuring improvement. Where relevant, the corrective action plan shall be developed in consultation with stakeholders;
  - (c) seek contractual assurances from a direct partner with whom it has an established business relationship that it will ensure compliance with the code of conduct and, as necessary, a corrective action plan, including by seeking corresponding contractual assurances from its partners, to the extent that they are part of the

value chain (contractual cascading). When such contractual assurances are obtained, paragraph 5 shall apply.

- (d) make necessary investments, such as into management or production processes and infrastructures to comply with paragraphs 1, 2 and 3;
- (e) provide targeted and proportionate support for an 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;
- (f) in compliance with Union law including competition law, collaborate with other entities, including, where relevant, to increase the company's ability to bring the adverse impact to an end, in particular where no other action is suitable or effective.

4. As regards actual adverse impacts that could not be brought to an end or adequately mitigated by the measures in paragraph 3, the company may seek to conclude a contract with a partner with whom it has an indirect relationship, with a view to achieving compliance with the company's code of conduct or a corrective action plan. When such a contract is concluded, paragraph 5 shall apply.

5. The contractual assurances or the contract shall be accompanied by the appropriate measures to verify compliance. For the purposes of verifying compliance, the company may refer to suitable industry initiatives or independent third-party verification.

When contractual assurances are obtained from, or a contract is entered into, with an SME, the terms used shall be fair, reasonable and non-discriminatory. Where measures to verify compliance are carried out in relation to SMEs, the company shall bear the cost of the independent third-party verification.

6. As regards actual adverse impacts within the meaning of paragraph 1 that could not be brought to an end or the extent of which could not be minimised by the measures provided for in paragraphs 3, 4 and 5, the company shall refrain from entering into new or extending existing relations with the partner in connection to or in the value chain of which the impact has arisen and shall, where the law governing their relations so entitles them to, take one of the following actions:

- (a) temporarily suspend commercial relationships with the partner in question, while pursuing efforts to bring to an end or minimise the extent of the adverse impact, or
- (b) terminate the business relationship with respect to the activities concerned, if the adverse impact is considered severe.

Member States shall provide for the availability of an option to terminate the business relationship in contracts governed by their laws.

7. By way of derogation from paragraph 6, point (b), when companies referred to in Article 3, point (a)(iv), provide credit, loan or other financial services, they shall not be required to terminate the credit, loan or other financial service contract, when this can be reasonably expected to cause substantial prejudice to the entity to whom that service is being provided.

## *Article 9*

### **Complaints procedure**

1. Member States shall ensure that companies provide the possibility for persons and organisations listed in paragraph 2 to submit complaints to them where they have legitimate concerns regarding actual or potential adverse human rights impacts and adverse environmental impacts with respect to their own operations, the operations of their subsidiaries and their value chains.
2. Member States shall ensure that the complaints may be submitted by:
  - (a) persons who are affected or have reasonable grounds to believe that they might be affected by an adverse impact,
  - (b) trade unions and other workers' representatives representing individuals working in the value chain concerned,
  - (c) civil society organisations active in the areas related to the value chain concerned.
3. Member States shall ensure that the companies establish a procedure for dealing with complaints referred to in paragraph 1, including a procedure when the company considers the complaint to be unfounded, and inform the relevant workers and trade unions of those procedures. Member States shall ensure that where the complaint is well-founded, the adverse impact that is the subject matter of the complaint is deemed to be identified within the meaning of Article 6.
4. Member States shall ensure that complainants are entitled
  - (a) to request appropriate follow-up on the complaint from the company with which they have filed a complaint pursuant to paragraph 1, and
  - (b) to meet with the company's representatives at an appropriate level to discuss potential or actual severe adverse impacts that are the subject matter of the complaint.

## *Article 10*

### **Monitoring**

Member States shall ensure that companies carry out periodic assessments of their own operations and measures, those of their subsidiaries and, where related to the value chains of the company, those of their established business relationships, to monitor the effectiveness of the identification, prevention, mitigation, bringing to an end and minimisation of the extent of human rights and environmental adverse impacts. Such assessments shall be based, where appropriate, on qualitative and quantitative indicators and be carried out at least every 12 months and whenever there are reasonable grounds to believe that significant new risks of the occurrence of those adverse impacts may arise. The due diligence policy shall be updated in accordance with the outcome of those assessments.

### *Article 11*

#### **Communicating**

Member States shall ensure that companies that are not subject to reporting requirements under Articles 19a and 29a of Directive 2013/34/EU report on the matters covered by this Directive by publishing on their website an annual statement in a language customary in the sphere of international business. The statement shall be published by 30 April each year, covering the previous calendar year.

The Commission shall adopt delegated acts in accordance with Article 28 concerning the content and criteria for such reporting under paragraph 1, specifying information on the description of due diligence, potential and actual adverse impacts and actions taken on those.

### *Article 12*

#### **Model contractual clauses**

In order to provide support to companies to facilitate their compliance with Article 7(2), point (b), and Article 8(3), point (c), the Commission shall adopt guidance about voluntary model contract clauses.

### *Article 13*

#### **Guidelines**

In order to provide support to companies or to Member State authorities on how companies should fulfil their due diligence obligations, the Commission, in consultation with Member States and stakeholders, the European Union Agency for Fundamental Rights, the European Environment Agency, and where appropriate with international bodies having expertise in due diligence, may issue guidelines, including for specific sectors or specific adverse impacts.

### *Article 14*

#### **Accompanying measures**

1. Member States shall, in order to provide information and support to companies and the partners with whom they have established business relationships in their value chains in their efforts to fulfil the obligations resulting from this Directive, set up and operate individually or jointly dedicated websites, platforms or portals. Specific consideration shall be given, in that respect, to the SMEs that are present in the value chains of companies.
2. Without prejudice to applicable State aid rules, Member States may financially support SMEs.
3. The Commission may complement Member States' support measures building on existing Union action to support due diligence in the Union and in third countries and may devise new measures, including facilitation of joint stakeholder initiatives to help companies fulfil their obligations.

4. Companies may rely on industry schemes and multi-stakeholder initiatives to support the implementation of their obligations referred to in Articles 5 to 11 of this Directive to the extent that such schemes and initiatives are appropriate to support the fulfilment of those obligations. The Commission and the Member States may facilitate the dissemination of information on such schemes or initiatives and their outcome. The Commission, in collaboration with Member States, may issue guidance for assessing the fitness of industry schemes and multi-stakeholder initiatives.

#### *Article 15*

#### **Combating climate change**

1. Member States shall ensure that companies referred to in Article 2(1), point (a), and Article 2(2), point (a), shall 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. This plan shall, in particular, identify, on the basis of information reasonably available to the company, the extent to which climate change is a risk for, or an impact of, the company's operations.
2. Member States shall ensure that, in case climate change is or should have been identified as a principal risk for, or a principal impact of, the company's operations, the company includes emission reduction objectives in its plan.
3. Member States shall ensure that companies duly take into account the fulfilment of the obligations referred to in paragraphs 1 and 2 when setting variable remuneration, if variable remuneration is linked to the contribution of a director to the company's business strategy and long-term interests and sustainability.

#### *Article 16*

#### **Authorised representative**

1. Member States shall ensure that each company referred to in Article 2(2) designates a legal or natural person as its authorised representative, established or domiciled in one of the Member States where it operates. The designation shall be valid when confirmed as accepted by the authorised representative.
2. Member States shall ensure that the name, address, electronic mail address and telephone number of the authorised representative is notified to a supervisory authority in the Member State where the authorised representative is domiciled or established. Member States shall ensure that the authorised representative is obliged to provide, upon request, a copy of the designation in an official language of a Member State to any of the supervisory authorities.
3. Member States shall ensure that a supervisory authority in the Member State where the authorised representative is domiciled or established and, where it is different, a supervisory authority in the Member State in which the company generated most of its net turnover in the Union in the financial year preceding the last financial year are informed that the company is a company within the meaning of Article 2(2).

4. Member States shall ensure that each company empowers its authorised representative to receive communications from supervisory authorities on all matters necessary for compliance with and enforcement of national provisions transposing this Directive. Companies shall be required to provide their authorised representative with the necessary powers and resources to cooperate with supervisory authorities.

#### *Article 17*

#### **Supervisory Authorities**

1. Each Member State shall designate one or more supervisory authorities to supervise compliance with the obligations laid down in national provisions adopted pursuant to Articles 6 to 11 and Article 15(1) and (2) ('supervisory authority').
2. As regards the companies referred to in Article 2(1), the competent supervisory authority shall be that of the Member State in which the company has its registered office.
3. As regards companies referred to in Article 2(2), the competent supervisory authority shall be that of the Member State in which the company has a branch. If the company does not have a branch in any Member State, or has branches located in different Member States, the competent supervisory authority shall be the supervisory authority of the Member State in which the company generated most of its net turnover in the Union in the financial year preceding the last financial year before the date indicated in Article 30 or the date on which the company first fulfils the criteria laid down in Article 2(2), whichever comes last.

Companies referred to in Article 2(2) may, on the basis of a change in circumstances leading to it generating most of its turnover in the Union in a different Member State, make a duly reasoned request to change the supervisory authority that is competent to regulate matters covered in this Directive in respect of that company.

4. Where a Member State designates more than one supervisory authority, it shall ensure that the respective competences of those authorities are clearly defined and that they cooperate closely and effectively with each other.
5. Member States may designate the authorities for the supervision of regulated financial undertakings also as supervisory authorities for the purposes of this Directive.
6. By the date indicated in Article 30(1), point (a), Member States shall inform the Commission of the names and contact details of the supervisory authorities designated pursuant to this Article, as well as of their respective competence where there are several designated supervisory authorities. They shall inform the Commission of any changes thereto.
7. The Commission shall make publicly available, including on its website, a list of the supervisory authorities. The Commission shall regularly update the list on the basis of the information received from the Member States.
8. Member States shall guarantee the independence of the supervisory authorities and shall ensure that they, and all persons working for or who have worked for them and auditors

or experts acting on their behalf, exercise their powers impartially, transparently and with due respect for obligations of professional secrecy. In particular, Member States shall ensure that the authority is legally and functionally independent from the companies falling within the scope of this Directive or other market interests, that its staff and the persons responsible for its management are free of conflicts of interest, subject to confidentiality requirements, and that they refrain from any action incompatible with their duties.

### *Article 18*

#### **Powers of supervisory authorities**

1. Member States shall ensure that the supervisory authorities have adequate powers and resources to carry out the tasks assigned to them under this Directive, including the power to request information and carry out investigations related to compliance with the obligations set out in this Directive.
2. A supervisory authority may initiate an investigation on its own motion or as a result of substantiated concerns communicated to it pursuant to Article 19, where it considers that it has sufficient information indicating a possible breach by a company of the obligations provided for in the national provisions adopted pursuant to this Directive.
3. Inspections shall be conducted in compliance with the national law of the Member State in which the inspection is carried out and with prior warning to the company, except where prior notification hinders the effectiveness of the inspection. Where, as part of its investigation, a supervisory authority wishes to carry out an inspection on the territory of a Member State other than its own, it shall seek assistance from the supervisory authority in that Member State pursuant to Article 21(2).
4. If, as a result of the actions taken pursuant to paragraphs 1 and 2, a supervisory authority identifies a failure to comply with national provisions adopted pursuant to this Directive, it shall grant the company concerned an appropriate period of time to take remedial action, if such action is possible.

Taking remedial action does not preclude the imposition of administrative sanctions or the triggering of civil liability in case of damages, in accordance with Articles 20 and 22, respectively.

5. When carrying out their tasks, supervisory authorities shall have at least the following powers:
  - (a) to order the cessation of infringements of the national provisions adopted pursuant to this Directive, abstention from any repetition of the relevant conduct and, where appropriate, remedial action proportionate to the infringement and necessary to bring it to an end;
  - (b) to impose pecuniary sanctions in accordance with Article 20;
  - (c) to adopt interim measures to avoid the risk of severe and irreparable harm.
6. Where the legal system of the Member State does not provide for administrative sanctions, this Article and Article 20 may be implemented in such a manner that the

sanction is initiated by the competent supervisory authority and imposed by the competent national courts, while ensuring that those legal remedies are effective and have an equivalent effect to the administrative sanctions imposed by supervisory authorities.

7. Member States shall ensure that each natural or legal person has the right to an effective judicial remedy against a legally binding decision by a supervisory authority concerning them.

#### *Article 19*

##### **Substantiated concerns**

1. Member States shall ensure that natural and legal persons are entitled to submit substantiated concerns to any supervisory authority when they have reasons to believe, on the basis of objective circumstances, that a company is failing to comply with the national provisions adopted pursuant to this Directive ('substantiated concerns').
2. Where the substantiated concern falls under the competence of another supervisory authority, the authority receiving the concern shall transmit it to that authority.
3. Member States shall ensure that supervisory authorities assess the substantiated concerns and, where appropriate, exercise their powers as referred to in Article 18.
4. The supervisory authority shall, as soon as possible and in accordance with the relevant provisions of national law and in compliance with Union law, inform the person referred to in paragraph 1 of the result of the assessment of their substantiated concern and shall provide the reasoning for it.
5. Member States shall ensure that the persons submitting the substantiated concern according to this Article and having, in accordance with national law, a legitimate interest in the matter have access to a court or other independent and impartial public body competent to review the procedural and substantive legality of the decisions, acts or failure to act of the supervisory authority.

#### *Article 20*

##### **Sanctions**

1. Member States shall lay down the rules on sanctions applicable to infringements of national provisions adopted pursuant to this Directive, and shall take all measures necessary to ensure that they are implemented. The sanctions provided for shall be effective, proportionate and dissuasive.
2. In deciding whether to impose sanctions and, if so, in determining their nature and appropriate level, due account shall be taken of the company's efforts to comply with any remedial action required of them by a supervisory authority, any investments made and any targeted support provided pursuant to Articles 7 and 8, as well as collaboration with other entities to address adverse impacts in its value chains, as the case may be.
3. When pecuniary sanctions are imposed, they shall be based on the company's turnover.



4. Member States shall ensure that any decision of the supervisory authorities containing sanctions related to the breach of the provisions of this directive is published.

#### *Article 21*

### **European Network of Supervisory Authorities**

1. The Commission shall set up a European Network of Supervisory Authorities, composed of representatives of the supervisory authorities. The Network shall facilitate the cooperation of the supervisory authorities and the coordination and alignment of regulatory, investigative, sanctioning and supervisory practices of the supervisory authorities and, as appropriate, sharing of information among them.

The Commission may invite Union agencies with relevant expertise in the areas covered by this Directive to join the European Network of Supervisory Authorities.

2. Supervisory authorities shall provide each other with relevant information and mutual assistance in carrying out their duties and shall put in place measures for effective cooperation with each other. Mutual assistance shall include collaboration with a view to the exercise of the powers referred to in Article 18, including in relation to inspections and information requests.
3. Supervisory authorities shall take all appropriate steps needed to reply to a request for assistance by another supervisory authority without undue delay and no later than 1 month after receiving the request. Such steps may include, in particular, the transmission of relevant information on the conduct of an investigation.
4. Requests for assistance shall contain all the necessary information, including the purpose of and reasons for the request. Supervisory authorities shall only use the information received through a request for assistance for the purpose for which it was requested.
5. The requested supervisory authority shall inform the requesting supervisory authority of the results or, as the case may be, of the progress regarding the measures to be taken in order to respond to the request for assistance.
6. Supervisory authorities shall not charge each other fees for actions and measures taken pursuant to a request for assistance.  
However, supervisory authorities may agree on rules to indemnify each other for specific expenditure arising from the provision of assistance in exceptional cases.
7. The supervisory authority that is competent pursuant to Article 17(3) shall inform the European Network of Supervisory Authorities of that fact and of any request to change the competent supervisory authority.
8. When doubts exist as to the attribution of competence, the information on which that attribution is based will be shared with the European Network of Supervisory Authorities, which may coordinate efforts to find a solution.

## *Article 22*

### **Civil liability**

1. Member States shall ensure that companies are liable for damages if:
  - (a) they failed to comply with the obligations laid down in Articles 7 and 8 and;
  - (b) as a result of this failure an adverse impact that should have been identified, prevented, mitigated, brought to an end or its extent minimised through the appropriate measures laid down in Articles 7 and 8 occurred and led to damage.
2. Notwithstanding paragraph 1, Member States shall ensure that where a company has taken the actions referred to in Article 7(2), point (b) and Article 7(4), or Article 8(3), point (c), and Article 8(5), it shall not be liable for damages caused by an adverse impact arising as a result of the activities of an indirect partner with whom it has an established business relationship, unless it was unreasonable, in the circumstances of the case, to expect that the action actually taken, including as regards verifying compliance, would be adequate to prevent, mitigate, bring to an end or minimise the extent of the adverse impact.

In the assessment of the existence and extent of liability under this paragraph, due account shall be taken of the company's efforts, insofar as they relate directly to the damage in question, to comply with any remedial action required of them by a supervisory authority, any investments made and any targeted support provided pursuant to Articles 7 and 8, as well as any collaboration with other entities to address adverse impacts in its value chains.
3. The civil liability of a company for damages arising under this provision shall be without prejudice to the civil liability of its subsidiaries or of any direct and indirect business partners in the value chain.
4. The civil liability rules under this Directive shall be without prejudice to 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 than this Directive.
5. Member States shall ensure that the liability provided for in provisions of national law transposing this Article is of overriding mandatory application in cases where the law applicable to claims to that effect is not the law of a Member State.

## *Article 23*

### **Reporting of breaches and protection of reporting persons**

Directive (EU) 2019/1937 shall apply to the reporting of all breaches of this Directive and the protection of persons reporting such breaches.

*Article 24*

**Public support**

Member States shall ensure that companies applying for public support certify that no sanctions have been imposed on them for a failure to comply with the obligations of this Directive.

*Article 25*

**Directors' duty of care**

1. Member States shall ensure that, when fulfilling their duty to act in the best interest of the company, directors of companies referred to in Article 2(1) 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.
2. Member States shall ensure that their laws, regulations and administrative provisions providing for a breach of directors' duties apply also to the provisions of this Article.

*Article 26*

**Setting up and overseeing due diligence**

1. Member States shall ensure that directors of companies referred to in Article 2(1) are responsible for putting in place and overseeing the due diligence actions referred to in Article 4 and in particular the due diligence policy referred to in Article 5, with due consideration for relevant input from stakeholders and civil society organisations. The directors shall report to the board of directors in that respect.
2. Member States shall ensure that directors take steps to adapt the corporate strategy to take into account the actual and potential adverse impacts identified pursuant to Article 6 and any measures taken pursuant to Articles 7 to 9.

*Article 27*

**Amendment to Directive (EU) No 2019/1937**

In Point E.2 of Part I of the Annex to Directive (EU) No 2019/1937, the following point is added:

‘(vi) [Directive ... of the European Parliament and of the Council of ... on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937\*+]’

#### Article 28

##### **Exercise of the delegation**

1. The power to adopt delegated acts is conferred on the Commission subject to the conditions laid down in this Article.
2. The power to adopt delegated acts referred to in Article 11 shall be conferred on the Commission for an indeterminate period of time.
3. The delegation of power referred to in Article 11 may be revoked at any time by the European Parliament or by the Council. A decision to revoke shall put an end to the delegation of the power specified in that decision. It shall take effect the day following the publication of the decision in the *Official Journal of the European Union* or at a later date specified therein. It shall not affect the validity of any delegated acts already in force.
4. Before adopting a delegated act, the Commission shall consult experts designated by each Member State in accordance with the principles laid down in the Interinstitutional Agreement of 13 April 2016 on Better Law-Making.
5. As soon as it adopts a delegated act, the Commission shall notify it simultaneously to the European Parliament and to the Council.
6. A delegated act adopted pursuant to Article 11 shall enter into force only if no objection has been expressed either by the European Parliament or the Council within a period of two months of notification of that act to the European Parliament and the Council or if, before the expiry of that period, the European Parliament and the Council have both informed the Commission that they will not object. That period shall be extended by two months at the initiative of the European Parliament or of the Council."

#### Article 29

##### **Review**

No later than ... [*OP please insert the date = 7 years after the date of entry into force of this Directive*], the Commission shall submit a report to the European Parliament and to the Council on the implementation of this Directive. The report shall evaluate the effectiveness of this Directive in reaching its objectives and assess the following issues:

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<sup>+</sup> OJ: Please insert in the text the number and the date of the Directive contained in document ... and insert the OJ reference of that Directive in the footnote.

- (a) whether the thresholds regarding the number of employees and net turnover laid down in Article 2(1) need to be lowered;
- (b) whether the list of sectors in Article 2(1), point (b), needs to be changed, including in order to align it to guidance from the Organisation for Economic Cooperation and Development;
- (c) whether the Annex needs to be modified, including in light of international developments
- (d) whether Articles 4 to 14 should be extended to adverse climate impacts.

### *Article 30*

#### **Transposition**

1. Member States shall adopt and publish, by ... [*OJ to insert: 2 years from the entry into force of this Directive*] at the latest, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith communicate to the Commission the text of those provisions.

They shall apply those provisions as follows:

- (a) from... [*OJ to insert: 2 years from the entry into force of this Directive*] as regards companies referred to in Article 2(1), point (a), and Article 2(2), point (a);
- (b) from ... [*OJ to insert: 4 years from the entry into force of this Directive*] as regards companies referred to in Article 2(1), point (b), and Article 2(2), point (b).

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

### *Article 31*

#### **Entry into force**

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

*Article 32*

**Addressees**

This Directive is addressed to the Member States.

Done at Brussels,

*For the European Parliament*  
*The President*

*For the Council*  
*The President*