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Proposed New EU Directive on Corporate Sustainability Due Diligence

The European Commission has published a proposed Directive on “Corporate Sustainability Due Diligence” (the “Proposed Directive”). The Proposed Directive would impose extensive and legally enforceable duties on large European companies, and on large non-EU companies doing business in Europe, with respect to the human rights and environmental impacts of their operations and value chains.

The Proposed Directive would initially apply to all EU companies with more than 500 employees and €150 million in annual turnover (revenues) worldwide and non-EU companies active in the EU with turnover generated in the EU of €150 million. Two years later, it would also apply to EU companies with 250 employees and €40 million annual turnover, and non-EU companies with turnover of €40 million generated in the EU, in defined “high impact sectors,” such as extractive industries, agriculture and textiles. The Commission estimates that the Proposed Directive would cover about 13,000 EU companies and about 4,000 non-EU companies.

Intended to go into effect two years after adoption by the European Parliament and Council, the Proposed Directive would require many companies to establish or strengthen their human rights and environmental policies, board responsibilities, due diligence procedures, and actions to avoid or mitigate adverse impacts. The requirements would be enforceable by administrative or judicial fines and enforcement orders. The Proposed Directive would allow suits for damages in European national courts – for which due diligence may be a defense.

An additional provision requires companies to adopt climate change plans in line with the 1.5 degree global warming target of the Paris Agreement.

The proposal must still be approved by the European Parliament and Council. Last year the Parliament approved an even stronger proposal. It will now be asked to approve this new proposal. Whether the Council (consisting of heads of state or government and top EU officials) will approve the proposed Directive remains to be seen. Once approved, member States will have only two years to implement the ultimately adopted Directive in domestic legislation. In any event, the Proposed Directive is a preview of legislation that is likely to be enacted in one form or another in the EU Member States. Companies should therefore pay heed to the requirements set out in the Proposed Directive now.

Practical Recommendations: It takes time to implement adequate human rights and environmental due diligence. Waiting until the Directive (or one of the other, domestic measures) comes into force runs the risk of leaving it until too late to introduce the necessary systems and processes, exposing a company to the risk of administrative penalties, civil liability and reputational damage. To get ahead of the curve, companies doing business in Europe should take steps now to:

- Review the sufficiency of existing policies, systems and processes to identify and address adverse human rights and environmental impacts. This will include looking both at its own operations and value chain, and at how its products and services are used, including by third parties.
- Where gaps are identified, take steps to address these, in accordance with international standards, to ensure that adequate systems and processes are in place.

Background: In April 2020, EU Justice Minister Didier Reynders announced that the European Commission would develop a proposal on human rights due diligence during 2021. The proposal was originally scheduled for release in June 2021, but its release was repeatedly postponed until February 23, 2022. Meanwhile, Germany, Norway and Switzerland adopted national legislation on the subject, joining France, which did so in 2017. Similar legislation is being considered in other European states.

Due Diligence: The Directive requires companies to follow the steps identified in the OECD Due Diligence Guidance for Responsible Business Conduct. As implemented in the Proposed Directive, these steps include

- integrate due diligence into policies and management systems;
- identify and assess actual or potential adverse human rights and environmental impacts;
- prevent or adequately mitigate (when prevention cannot be done) potential adverse impacts;
- cease or minimize (when cessation cannot be done) actual adverse impacts, including by financial payments to affected persons and communities;
- periodically assess the effectiveness of the due diligence policy and measures;
- publicly communicate on due diligence; and
- provide for remediation, including appropriate procedures for complaints by affected persons, trade unions and civil society organizations.

Due diligence should address adverse impacts throughout the life-cycle of production and use and disposal of products or services, in a company's own operations and in those of its subsidiaries and value chain.

Director Responsibilities: The Directive would impose duties for directors of covered EU companies. Duties include adopting a due diligence policy, setting up and overseeing the implementation of due diligence processes, and integrating due diligence into the corporate strategy. In addition, when directors act in the interest of the company, they have a duty of care to take into account the human rights, climate and environmental consequences of their decisions and the likely short, medium and long-term consequences. When remuneration is linked to a director's contribution to business strategy and long-term interests and sustainability, companies must take due account of the fulfilment of the corporate climate change plan. Rules on directors' duties will be enforced through existing Member States' laws.

Administrative Fines and Orders: National administrative enforcement tools will include sanctions and orders to cease or suspend infringing actions. Administrative or judicial fines for failure to conduct adequate due diligence should be "dissuasive, proportionate and effective."

Civil Suits for Damages: Civil liability concerns a company's own operations and those of its subsidiaries and established business relationships with which it cooperates on a regular and frequent basis. Liability may arise where the harm could have been identified, and prevented, adequately mitigated, ended, or minimized, by appropriate due diligence measures. Due diligence should be a defense to liability, except where it was unreasonable to expect that the measures taken would suffice to prevent, mitigate, end, or minimize the adverse impact. The issue of which party has the burden of proof on whether measures were adequate is left to national law. Member states are required to adapt their rules on civil liability to cover cases where damage results from failure by a company to comply with due diligence obligations.

High Risk Sectors: High-impact sectors under the Directive include manufacture and wholesale trade of textiles, clothing and footwear; agriculture, forestry, and fisheries; manufacture of food products; wholesale trade of agricultural raw materials, live animals, wood, food, and beverages; extractive industries; manufacture of basic metal and mineral products (except machinery and equipment); and wholesale trade of mineral resources and basic and intermediate mineral products. Additional



sectors may be added in the future. The financial sector is not high-impact but should include very large companies as regulated financial undertakings.

Human Rights: Unlike the *UN Guiding Principles on Business and Human Rights*, the Proposed Directive does not cover “all internationally recognised human rights”. Instead, it covers certain specified human rights considered relevant to business activity, as recognized in international instruments. Nevertheless, the scope of the Proposed Directive is broad. Covered rights range from the rights to life; personal security; liberty; freedom from torture; privacy; freedom of thought, conscience and religion; children’s rights; and freedom from slavery and human trafficking; to economic rights, including the rights to dispose of a land’s natural resources; non-deprivation of means of subsistence; labor rights including fair and adequate living wages, decent working conditions, freedom from forced and child labor, non-discrimination and rights to associate, assembly, organize unions and engage in collective bargaining; freedom from harmful environmental degradation; freedom from unlawful eviction and development; and rights of indigenous peoples to land, territories and resources.

In addition, the Proposed Directive protects other rights in some 22 international instruments, where a violation “directly impairs” a protected legal interest, and the company could have “reasonably established the risk” of impairment and appropriate measures to be taken in the circumstances. These instruments include 12 leading human rights treaties and declarations of the United Nations, and the two main declarations and eight core conventions of the International Labor Organization.

Environment: In addition to the human right to be free from harmful environmental degradation (see above), the environmental rights covered by the Proposed Directive include rights protected by specified international conventions and EU regulations on biodiversity, endangered species, mercury, toxic chemicals and waste, ozone depletion, and hazardous waste.

Climate Change: Companies should have a strategy to ensure that their business plans are compatible with the 1.5 degree global warming target of the Paris Agreement. Companies for which climate is a principal risk should include emissions reduction targets in their plans. Although the Proposed Directive does not mandate civil remedies for failure to comply, neither does it prohibit national courts from ordering remedies. Climate change cases against companies under national laws are already pending in France, Germany and The Netherlands.

Value Chains: Value chains include direct and indirect established business relationships, both upstream and downstream. Companies should utilize contractual provisions and financial or technical assistance to build and exercise leverage over small and medium enterprises in their value chain. Companies should prioritize engagement with entities in the value chain rather than termination, which should be only a last resort.

Costs for Companies: Covered companies are expected to incur added costs for establishing and operating due diligence processes. They may also incur transition costs from investments needed to change their operations and value chains to address adverse impacts.

EU Regulatory Context: In 2021 the Commission proposed a new *Corporate Sustainability Reporting Directive*, which will require more extensive reporting than the existing *EU Non-Financial Reporting Directive* of 2014. The proposed new *Corporate Sustainability Due Diligence Directive* (“*Due Diligence Directive*”) would “underpin” reporting under the proposed reporting Directive, and under the *EU Sustainable Finance Disclosure Regulation* governing financial market participants and advisers.

The proposed *Due Diligence Directive* is intended to complement other EU initiatives. They include the recent *Taxonomy Regulation*, which categorizes environmentally sustainable investments in economic activities that also meet a minimum social safeguard; the *Directive on human trafficking*; the *Employer Sanctions Directive*, which prohibits employment of “irregularly staying third-country nationals;” the *Conflict Minerals Regulation*; the proposed *Regulation on deforestation-free supply chains*; the proposed *Batteries Regulation*; and the future *Sustainable Products Initiative*. The European Commission is separately preparing a legislative proposal that will effectively prohibit the placing on the EU market of products made by forced labor, including forced child labor.

The proposed *Due Diligence Directive* is without prejudice to other EU legislation on human rights, the environment and climate change. In case of conflict, the other legislation prevails.

The full proposal is accessible [here](#).



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