



RESPONSIBLE BUSINESS

Corporate sustainability due diligence: here we come!

The European Commission has released the long-awaited proposal for a directive on corporate sustainability due diligence.

As expected following the resolution approved by the European Parliament on 10 March 2021, the implications for companies are many and will have an impact on their organisation and the way they conduct themselves. The directive also affects the companies and other organisations they have commercial relations with.

Companies will be required to identify and, where necessary, prevent, eliminate or mitigate the adverse impacts of their activities on human rights, such as child labour and exploitation of workers, and the environment, for example pollution and biodiversity loss.

Several Member States had already introduced national due diligence rules and some companies had also decided to take action voluntarily. However, the European Commission considered that this patchwork of rules has created distortions between companies and voluntary adoption was unlikely to have the necessary impact.

Companies covered

The new due diligence rules will apply to both EU-based companies and third-country companies operating in the EU, and this targeting of third-countries is increasingly common in European regulation.

In the case of EU companies, the rules will apply to:

- companies with substantial size and economic power, that is, companies with more than 500 employees and EUR 150 million net turnover worldwide;

Companies will be required to identify and, where necessary, prevent, eliminate or mitigate the adverse impacts of their activities on human rights.

- other companies operating in defined high-impact sectors such as agriculture, textiles and minerals, which (without reaching both thresholds above) have more than 250 employees and a net turnover of EUR 40 million or more worldwide. For these companies, the rules will start to apply two years later.

The directive will also apply to third-country companies operating in the EU with a turnover generated in the EU exceeding the above thresholds. These companies will be required to appoint an EU-based representative for the purposes of the directive.

The proposal applies not only to the operations of the company itself and its subsidiaries, but also to their value chains.

The proposal applies not only to the operations of the company itself and its subsidiaries, but also to their value chains (established direct and indirect business relationships).

SMEs are not directly covered by the scope of this proposal. However, they will certainly be greatly affected when they are part of the value chain of large companies, and this will be particularly relevant for exporting companies.

Financial sector

The directive refers expressly on several occasions to its application to the financial sector. This is the result of the debate that has taken place as to the application of the UN Human Rights Council's Guiding Principles on Business and Human Rights (UNGPs) to this sector.

The activities of companies that are to be included in the value chain of financial institutions as a result of the financial services provided should include only the activities directly financed by or subject to that service. SMEs cannot be included in that chain.

Moreover, when granting credit or providing financial services, actual and potential adverse impacts on human rights and adverse environmental impacts should only be identified before the credit is granted or the service provided.

In the context of ending or mitigating the actual impact, financial institutions will not be obliged to terminate the credit, loan or other financial service agreement if this could reasonably be expected to cause substantial harm to the debtor or the entity to whom that service is provided.

More immediate practical content of the due diligence duty

In order to fulfil their due diligence duty, companies must:

- have a plan to ensure that their business strategy is compatible with limiting global warming to 1.5 °C in accordance with the Paris Agreement (applicable to large companies only);
- integrate due diligence into their strategies;
- identify actual and potential human rights and environmental adverse impacts;

- prevent or reduce potential impacts;
- put an end to actual impacts or minimise them;
- establish and maintain a complaints procedure;
- monitor the effectiveness of the due diligence strategy and measures;
- report on due diligence and its implementation.

Relevant adverse impacts

Due diligence under the directive should be carried out with respect to all adverse impacts on human rights and the environment identified in the annex to the directive.

This means that companies must take appropriate measures to prevent, eliminate or mitigate impacts on the rights and prohibitions set out in international human rights agreements. These include the right to enjoy fair and favourable working conditions, such as a living wage, a decent life, safe and healthy working conditions and reasonable limitation of working hours, prohibition of child labour and forced labour. Companies are also required to take measures to prevent, eliminate or mitigate negative environmental impacts that contravene various multilateral conventions in the field of the environment. Among others, there is the obligation to take necessary measures in relation to the use of biological resources to avoid or minimise adverse impacts on diversity. Companies must also ensure they do not violate the prohibition on handling, collection, storage and disposal of waste in a manner that is not environmentally sound, etc.

Duty to end or minimise actual impacts

The directive expressly provides for a duty to minimise or end any actual impacts that may occur.

This duty includes the obligation to:

- neutralise the adverse impact or minimise its extent, including by paying compensation to affected people or communities;
- where the adverse impact cannot be terminated immediately, develop and implement a corrective action plan with clearly defined timelines for action and qualitative and quantitative indicators for measuring improvement;
- obtain contractual commitments from a partner with whom it has established a business relationship that it will comply with the code of conduct and, as necessary, a corrective action plan, including by obtaining contractual commitments from its partners to the extent that they are part of the value chain (contractual cascading);
- make the necessary investments in management or production processes and infrastructure;

- provide targeted and proportionate support to an SME with which the company has an established business relationship, where compliance with the code of conduct or corrective action plan would jeopardise the viability of the SME;
- work with other entities, including, where relevant, to enhance the company's ability to terminate the adverse impact, in particular where no other action is appropriate or effective.

The position of directors

The directors of the companies concerned are obliged to implement and supervise the application of internal due diligence processes and integrate due diligence into the corporate strategy.

The directors of the companies concerned are obliged to implement and supervise the application of internal due diligence processes and integrate due diligence into the corporate strategy.

The directive expressly provides that, in making their decisions, directors must take into account the human rights, climate and environmental consequences that may result. They must also consider the likely long-term consequences of any decision. In our view, in Portugal, directors who wish to apply the business judgment rule should already take these consequences into account, and this express rule may have even broader impacts.

Besides this, any variable remuneration that is linked to a director's contribution to the company's business strategy, as well as to long-term interests and sustainability, should properly take into account compliance with the obligations of the business plan regarding climate change.

Enforcement mechanisms

The proposal provides for the establishment of national independent administrative authorities to be set up by Member States. These authorities will be responsible for the supervision of compliance with these new rules and will be able to impose fines for non-compliance based on companies' turnover (as is the case in the GDPR).

In addition, victims will have the possibility to take legal action to recover any losses that could have been avoided through due diligence measures. ■