Ondernemingsrecht

Financieel recht

Special: The Proposal for a Corporate Sustainability Due Diligence Directive

Wolters Kluwer

NP/ONDSREC-MI23005 2023-5 *4 april 2023*

Table of Contents Issue 5

Colofon

Ondernemingsrecht
Dit tijdschrift informeert u diepgaand over onderwerpen op het gebied van het Ondernemingsrecht en het financieel recht. Bovendien is aandacht voor relevante onderwerpen op het gebied van Europees, economisch, mededingings-, sociaal, insolventie- en fiscaal recht. De inhoud bestaat uit een column, artikelen, actualiteiten, commentaren op rechtspraak en boekbesprekingen. Ondernemingsrecht (1999) is ontstaan door een fusie tussen De Naamlooze Vennootschap (1922) en TVVS (1958).

Ondernemingsrecht en ECFR
Ondernemingsrecht heeft een samenwerkingsverband met **European Company and Financial Law Review (ECFR)** <www.degruyter.de/journals/ecfr/> onder redactie van ‘Zeitschrift für Unternehmens-und Gesellschaftsrecht’ (ZGR).

Ondernemingsrecht
is een uitgave van Wolters Kluwer,
Postbus 23, 7400 GA Deventer.

Uitgever
Mr. H.G.D. (Daniël) ter Horst
e-mail: daniel.ter.horst@wolterskluwer.com

Citeerwijze
Ondernemingsrecht jaartal/publicatienummer, paragraafnummer
Ondernemingsrecht 2023/44, par. 3.1

Tarieven abonnementen
Raadpleegt u voor de abonnementsmogelijkheden en de bijbehorende prijzen onze shop:
shop.wolterskluwer.nl/, zoeken op ‘Ondernemingsrecht’.

Abonnementenadministratie
Wolters Kluwer Nederland Klantenservice
Postbus 23
7400 GA Deventer
Tel.: 0570-673555
wolterskluwer.com/nl-nl/solutions/nederland/klantenservice

Media advies / advertentiedeelname
Tim Lansbergen
Cross Media Nederland BV
Nieuwe Haven 133, 3116 AC Schiedam
Tel.: 010-7421022
e-mail: tim@crossmedianederland.com

ISSN 1389-1456

Wolters Kluwer

MIX
Papier van verantwoorde herkomst
FSC® C004472

Steven Hijink & Matthijs de Jongh[1]

From Company Law to "Value Chain Law": Observations and Dilemmas on the CSDDD Proposal

Ondernemingsrecht 2023/29

Column

This special issue of *Ondernemingsrecht* is, for various reasons, special. The issue, edited entirely in English, comments on the various aspects of the Corporate Sustainability Due Diligence Directive ("CSDDD") which has been proposed by the European Commission on 23 February 2022.[2]

The CSDDD proposal can be seen as the next step in the evolution of company law, which is increasingly aligned with the economic reality and to a lesser and lesser extent with the legal personality of individual legal entities. This shift in emphasis has already been visible for some time, e.g. in accounting law, in financial supervision regulations, and in competition law. For regulatory purposes, the group context in which the business activities are carried out has become increasingly important. With the proposal for the CSDDD – but actually also already in the recently adopted European Corporate Sustainability Reporting Directive ("CSRD")[3] – a further step has been taken: (regulating) the companies' value chain.

At the same time, the CSDDD illustrates another development. It is increasingly acknowledged that limited liability of shareholders is an important source of externalities. The climate crisis has made us aware that it no longer suffices to delegate the regulation of externalities to other areas of the law such as environmental law. The problem of externalities created by limited liability has become a defining issue of company law itself. The externalities debate is potentially even pushing away the shareholder/stakeholder discourse that has dominated the international corporate governance discussion over the past decades.

These two developments – abstracting from individual legal entities and regulation of externalities associated with the conduct of a business – come together in the CSDDD proposal. The proposal includes far-reaching provisions to mitigate externalities of various kinds: human rights, workers' rights, environment and climate change, as well as responsibilities for companies and their directors to exercise due diligence with regard to preventing and mitigating externalities throughout the value chain.

The consequences of the CSDDD are considerable. Therefore, it is not surprising that the CSDDD proposal has given rise to an intense debate both in Brussels and in member states. This involves numerous complex dilemmas at various levels. The past decades with increased globalisation and specialisation in business activities, have led to internationally operating companies and business activities characterised by cross-border aspects. The COVID crisis, and its aftermath, as well as the war in Ukraine have highlighted how internationally intertwined the supply chains and markets of modern enterprise are. This cross-border nature of modern enterprise is a given, but it also raises geopolitical questions. For example, is the European Union capable of enforcing due diligence obligations beyond its own borders? Relevant here is the geopolitical competition between the United States of America and China and a great need for raw materials – in the current transition era both fossil and raw materials are need-

1 Steven Hijink is Professor of Corporate Reporting Law at Radboud University Nijmegen (Van der Heijden Institute) and attorney at law in Amsterdam. Matthijs de Jongh is Professor of Corporate Law at Erasmus University Rotterdam. He is also a judge at the Amsterdam Court of Appeal (Enterprise Chamber). Both are editors of this journal.

2 Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, Brussels, 23 February 2022, COM(2022) 71 final, 2022/0051(COD).

3 Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (*OJ EU* 322, 2022).

ed for the energy transition. Is the European Union overplaying its regulatory hand and running the risk of other parties setting international standards when the European Union gets too far ahead of the global troops? At the same time, the severity of the climate and biodiversity crisis calls for a profound redefinition of the economy and how companies act in society. Given the nature of the problem, we cannot afford to wait to take action until there is global agreement on the content of that action.

Against this background, the CSDDD proposal contains provisions that are challenging in several respects. Provisions in the CSDDD (may) lead to implementation dilemmas: companies will enter (partly) new territory, which may require a lot of effort. The CSDDD proposal also contains several ambiguities. For this reason, the CSDDD proposal has generated both enthusiasm and fervent opposition. The course of the political discussion in the European Union about the proposal – which at the time of finalising this special issue, early March 2023, has not yet been concluded – also demonstrates this. In the Netherlands, moreover, a fierce discussion is going on about how the CSDDD relates to national policy initiatives, in the form of the proposal for the Responsible and Sustainable International Business Act.[4]

The main aspects of the proposal for the CSDDD are addressed by a variety of authors in this special issue. In the first contribution, Tineke Lambooy outlines the wider context for introducing the CSDDD. A second overview article on background to the CSDDD is by Jean-Philippe Robé entitled Steering Towards Sustainability. Samuel Garcia Nelen then provides an overview of the latest status of the CSDDD legislative process.

Subsequent contributions discuss various substantive aspects of the CSDDD proposal. Anne Lafarre writes about mandatory corporate sustainability due diligence in global value chains and compares the long-awaited European solution to existing international due diligence standards. Kitty Lieverse & Menno Baks then explore the proposals in the CSDDD regarding supervision and enforcement. Tomas Arons & Manuel Lokin discuss in their contribution the proposed requirement in the CSDDD for large companies to adopt a climate transition and the interaction between the CSDDD and the CSRD.

Two contributions then focus on the civil liability provisions included in the CSDDD proposal. Loes Lennarts writes about the civil liability of companies for failure to conduct corporate sustainability due diligence throughout their value chains and addresses the question of whether Article 22 CSDDD is fit for purpose. The contribution of Alessio Pacces provides an assessment of civil liability from a law and economics perspective. Mieke Olaerts subsequently explores the concept of using directors' duties in the quest for sustainable decision-making. In the final contribution of this special issue, Davina Roessingh, Hylke ten Bruggencate, Lisanne Baks & Sven Dumoulin discuss several expected practical implications of the proposed CSDDD from a business perspective.

The contributions in this issue show that criticism of, and endorsements for, the CSDDD proposal alternate. This illustrates the importance of the CSDDD. One note of relativity is appropriate here. It was not without reason that we pointed out above the importance of the CSRD already established. Important sustainability issues covered by the CSDDD proposal will – regardless of the political outcome of the CSDDD – have to be reported on by companies on the basis of the CSRD. As a matter of fact, these obligations laid down in the CSRD imply that companies have to address sustainability matters. Consequently, sustainability has already been incorporated into the directors' duties. Obviously, this does not alter the fact that the discussion about the CSDDD proposal will not be concluded for the time being. With this special issue, the editorial board of *Ondernemingsrecht* hopes and expects to have contributed to the European discussion on the future of sustainable business.

4 *Kamerstukken II* 2022/23, 35 761, nr. 9.

Tineke Lambooy[1]

Sketching the Wider Context for Introducing the EU Corporate Sustainability Due Diligence Directive (CSDDD)

Ondernemingsrecht 2023/30

- **Corporate sustainability due diligence assessments become mandatory.**
- **Companies must assess potential and actual environmental, human rights and labour rights risks and damage-causing activities in their international value chains and act upon the findings.**
- **The CSDDD aims to regulate corporate activities so that we can stay within the Planetary Boundaries, realise the Paris Agreement goals and enjoy an economic model with due respect for human rights and labour rights.**

This contribution provides a historical and general background to the topic of this special issue on the upcoming European legislation on corporate sustainability due diligence. Our economic behaviour and consumption patterns are threatening the geo-physical boundaries for a safe operating space for humanity and the greater community of live. Corporate activities around the world amplify such threats. They also have an impact on human rights and labour rights. To reduce any adverse impacts on the environment and people and to redress damages, companies need to assess the risks of actual and potential damage-causing activities in their international value chains. The European Union has now decided to oblige (large) companies to perform due diligence assessments as an important part of executing corporate social responsibility and to act upon the results thereof. In this contribution, these developments are analysed within the wider context of corporate social responsibility and already existing legislation on corporate sustainability due diligence.

1. The Problem Statement

> *"We, along with the greater community of life who we share the planet with, are responsible to keep the planet alive, habitable, and thriving. If we do not contribute to planetary well-being, we will make our planet less habitable for all of us as well as for all other species on this planet" (Earth Charter)*[2]

Physicist Johan Rockström, together with Will Steffen, Sarah Cornell and other scientists of the Swedish Resilience Centre, have developed a theory on 'Planetary Well-being'. In their studies, they identified nine geo-physical processes that regulate the stability and resilience of the Earth system as a whole. Hence, they proposed "quantitative planetary boundaries within which humanity can continue to develop and thrive for generations to come": the 'Planetary Boundaries'.[3] These are: climate change, biosphere integrity (functional and genetic), ocean acidification, depletion of the ozone layer, atmospheric aerosol pollution, biogeochemical flows of nitrogen and phosphorus, freshwater use, land-system change, and release of novel chemicals (including heavy metals, radioactive materials, plastics, and more). See figure 1 (on page 202). The boundaries indicate the tipping points for each of the examined geo-physical perspectives. As the boundaries affect each other, crossing one can start a chain of events that can lead to an implosion of all ecosystems and large-scale abrupt or irreversible environmental changes.[4] The Planetary Boundaries define to what extent we can change those geo-physical processes but still stay within the 'Safe Operating Space for Humanity' (i.e., the green circle in the middle of figure 1). In January 2022, it was concluded that humanity has exceeded the boundary related to environmental pollutants and other "novel entities" including plastics. Boundaries which were already transgressed are climate change, biosphere integrity, biogeochemical cycles (nitrogen and phosphor), and land system change. As regards climate change, data generated by the Intergovernmental Panel on Climate Change and projections based thereon have since long revealed that we are not staying within the safe boundaries.[5]

1 Prof. dr. Tineke Lambooy, LL.M. is professor Corporate Law at Nyenrode Business University (Breukelen-Amsterdam, the Netherlands) and Chair of the ICSR Metals Agreement (IMVO Metaalconvenant; hosted at the Socio-Economic Council, The Hague, the Netherlands).

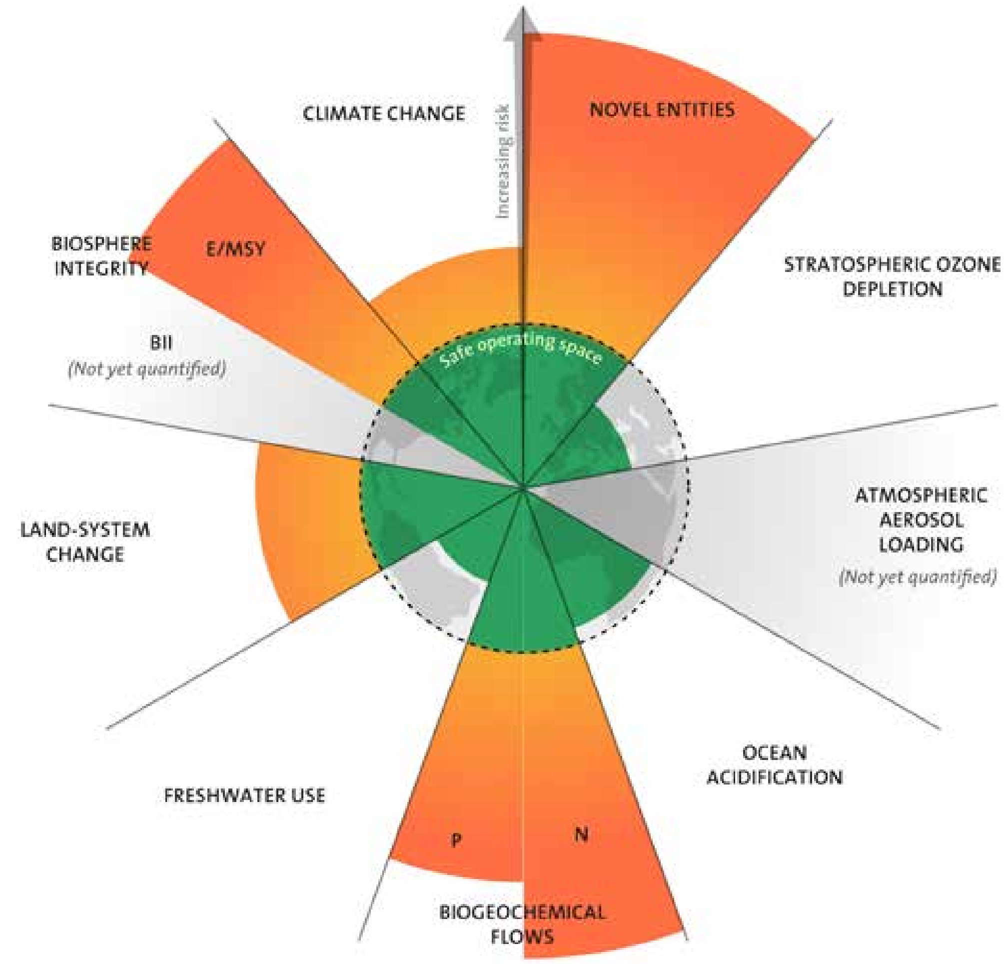
2 The Earth Charter, Library; earthcharter.org/library/the-earth-charter-text.

3 Stockholm Resilience Centre: Planetary boundaries; www.stockholmresilience.org/research/planetary-boundaries.html.

4 Idem.

5 Intergovernmental Panel on Climate Change, Reports; www.ipcc.ch/reports/.

Figure 1. The Planetary Boundaries: Exceeding the Novel Entities Boundary[6]



By April 2022, the Swedish Resilience Centre indicated that the safe limit of the freshwater boundary is also being exceeded. This conclusion resulted from the reassessment of the planetary boundary for freshwater executed by a research team led by Lan Wang.[7] This boundary now also includes "green water", i.e., rainfall, soil moisture and evaporation, which represents the water available to plants. As the reassessment showed that "green water is considered to be outside safe zone of Holocene-like conditions based on global changes to soil moisture", the inclusion of "green water" into the freshwater boundary assessment led to the conclusion that the freshwater boundary is transgressed.[8] This study stresses that green water links the freshwater boundary tightly to other planetary boundaries such as land use, biodiversity and climate. Hence, the transgression of the freshwater boundary also affects several other boundaries.[9] The Earth is losing a green water stability that it has had for several thousands of years. The research team claims that "Reducing Earth system risks of green water change now requires immediate water-wise actions to address climate change, deforestation, and soil degradation".[10] As expressed by Lan

6 https://stockholmuniversity.app.box.com/s/0hkuwr7t8p5g3ygcktvafb8olw81wuqf. Credit: Azote for Stockholm Resilience Centre, based on the analyses in Persson, L., Carney Almroth, B.M., Collins, C.D., Cornell, S., de Wit, C. et al. (2022), 'Outside the Safe Operating Space of the Planetary Boundary for Novel Entities', Environ. Sci. Technol.; doi.org/10.1021/acs.est.1c04158; and: Steffen, W., Richardson, K., Rockström, J., Cornell, S.E. et al. (2015), 'Planetary boundaries: Guiding human development on a changing planet', Science 347: 736, 1259855; www.science.org/doi/10.1126/science.1259855.

7 Stockholm Resilience Centre: Freshwater boundary exceeds safe limits; www.stockholmresilience.org/research/research-news/2022-04-26-freshwater-boundary-exceeds-safe-limits.html. Wang-Erlandsson, L., Tobian, A., Van der Ent, R.J., Fetzer, I., te Wierik, S., Porkka, M., Staal, A., Jaramillo, F., Dahlmann, H., Singh, C., Greve, P., Gerten, D., Keys, P.W., Gleeson, T., Cornell, S.E., Steffen, W., Bai, X., Rockström, J., (2022), 'A planetary boundary for green water', *Nature Reviews Earth & Environment*; rdcu.be/cL78K.

8 Idem.

9 Idem. They articulated: "The Amazon rainforest depends on soil moisture for its survival. But there is evidence that parts of the Amazon are drying out. The forest is losing soil moisture as a result of climate change and deforestation" and "These changes are potentially pushing the Amazon closer to a tipping point where large parts could switch from rainforest to savannah-like states." Apparently, it concerns not only in the Amazon as the phenomenon described by them appears to be global, i.e., from the boreal forests to the tropics, from farmlands to forests, soil moisture is changing resulting in abnormally wet and dry soils.

10 Idem.

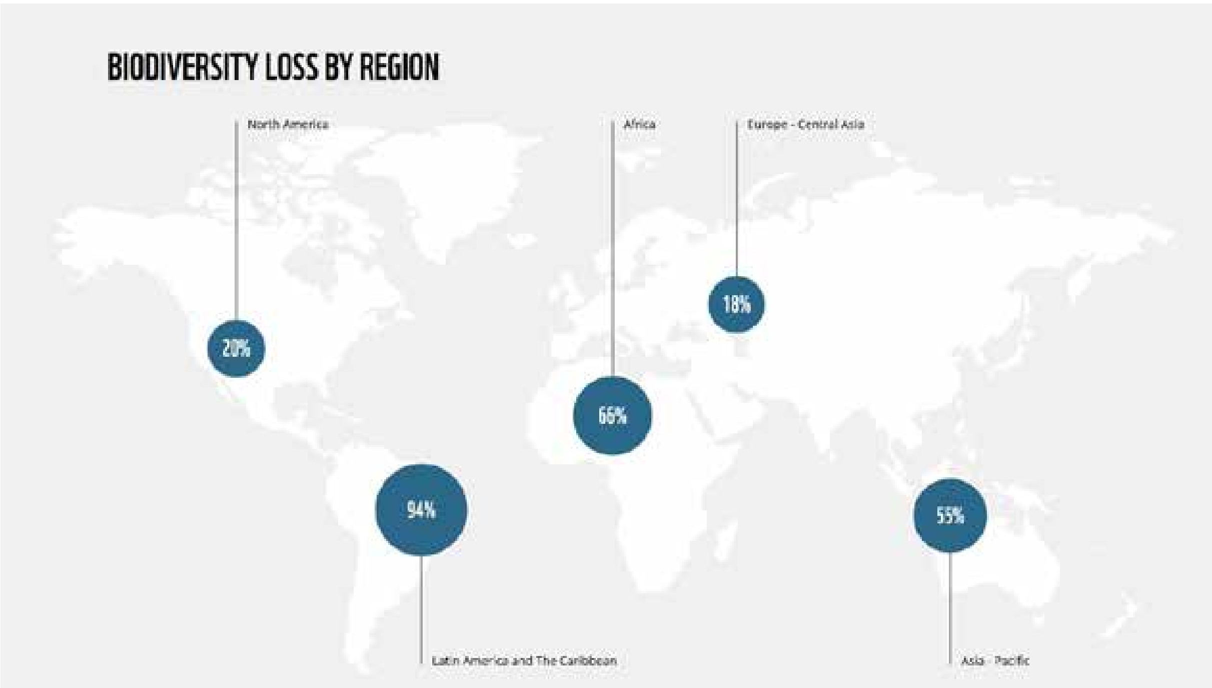
Wang, the lead author: "Water is the bloodstream of the biosphere. But we are profoundly changing the water cycle. This is now affecting the health of the entire planet."[11] Clearly, *our planet is in trouble*.

Another and very crucial transgressed Planetary Boundary is biosphere integrity. According to Rockström, "biodiversity is one of the pillars supporting our planet". He explains that "if too much biodiversity is lost, we risk triggering a tipping point in our climate or oceans, which in turn could risk pushing the planet into a new state." Furthermore: "Without biodiversity, no ecosystems. No ecosystems, no biomes. No biomes, no living regulator of all the cycles of carbon, nitrogen, oxygen, carbon dioxide and water."[13]

An important source concerning the state of global biodiversity are the studies presented in the WWF's Living Planet Reports 2020 and 2022.[14] These reports reveal the (un)-healthiness of the biodiversity in ecosystems around the world and clarify the link with economic activities. Biodiversity – the rich diversity of life on Earth – is being lost at an alarming rate, i.e., an average decline of 69% in species populations (mammals, birds, fish, amphibians and reptiles) since 1970.[15] Hence, in less than 50 years we have caused an enormous decrease in biodiversity worldwide. Our relationship with nature is broken and need to be rebalanced.[16] This loss impacts the greater community of life as well as our own health and well-being, and in particular the human rights of many people who need access to water and food. Figure 2 shows in which areas the biodiversity loss happens faster and/or at a larger scale than elsewhere. Clearly, the greatest losses appear in Brazil, Indonesia and the whole of Africa (the Global South), thus the area's from where we (the North) import most of our raw materials and agricultural products.

The crossing of the Planetary Boundaries and the decrease of biodiversity and healthy eco-systems does not happen by itself. The Living Planet Report 2020 explains that various threats drive the loss of biodiversity, comprising: (i) indirect drivers, including consumption, demography, etc.; (ii) pressures like fishery, agriculture and mining; and (iii) direct drivers, such as pollution, overexploitation, habitat loss and degradation.

Figure 2. The Biodiversity Loss by Region (2022)[12]



11 Idem.
12 Living Planet, Homepage, Biodiversity loss by region; livingplanet.panda.org/en-US/.
13 *The Guardian*, 16 January 2018, 'Could biodiversity destruction lead to a global tipping point?'; www.theguardian.com/environment/radical-conservation/2018/jan/16/biodiversity-extinction-tipping-point-planetary-boundary.
14 WWF (2020) *Living Planet Report 2020 – Bending the curve of biodiversity loss*. Almond, R.E.A., Grooten M. & Petersen, T. (Eds). WWF, Gland, Switzerland. WWF (2022) *Living Planet Report 2022 – Building a nature-positive society*. Almond, R.E.A., Grooten, M., Juffe Bignoli, D. & Petersen, T. (Eds). WWF, Gland, Switzerland; www.wwf.org.uk/sites/default/files/2022-10/lpr_2022_full_report.pdf.
15 Living Planet, Homepage, Biodiversity loss by region; livingplanet.panda.org/en-US/.
16 WWF 2022, supra n. 14, p. 5.

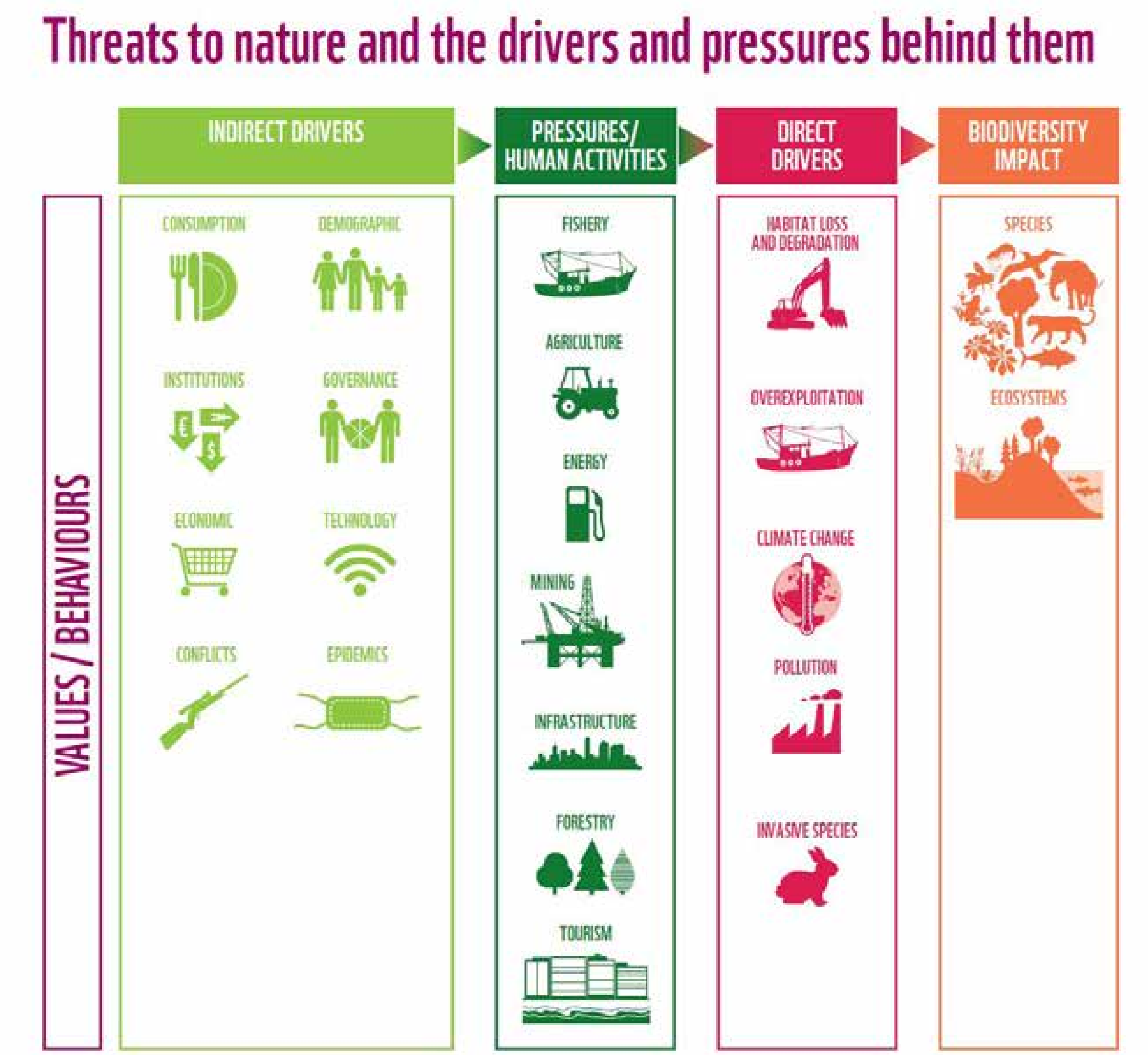
The destruction of and pressure on nature ultimately affect human existence as pointed out by the Planetary Boundaries' and WWF' studies. In the interim they mostly harm the existence and (traditional) way of living of the people inhabiting the areas that suffer the most from destruction and pressure.

The visual in figure 3 demonstrates that economic activity, organised by companies, governments and individual people cause the main threats. Against this background, (International) Corporate Social Responsibility (CSR), or using another term Responsible Business Conduct (RBC), requires of companies to perform due diligence assessments in their worldwide value chains. The goal thereof is to detect the pressures of their business model and activities, and any adverse impacts on nature, the (human rights of the) people inhabiting the area where the activities take place and the (labour rights of their) employees.

2. Civil Society Action Advocated for Legal Norms

Since the 90s of the last century, the adverse impacts of business activities on nature and people have been mapped by civil society organisations (CSOs), among which non-governmental organisations (NGOs) and unions, and

Figure 3. WWF: Threats to Nature and the Drivers and Pressures behind them[17]



17 WWF 2020, p. 53 supra note 14; files.worldwildlife.org/wwfcmsprod/files/Publication/file/279c656a32_ENGLISH_FULL.pdf?_ga=2.10410551.301457564.1677233315-1972789142.1677233314.

researched by academics.[18] CSOs campaigned and litigated against, among other, oil and gas companies (Shell in Nigeria – Ken Saro Wiwa),[19] mining companies (Rio Tinto, Freeport in West Papua), industrial fishing companies,[20] chemical and pharmaceutical companies (Monsanto, Union Carbide – Bhopal, DES), tobacco companies (Philip Morris, BAT), banks,[21] and other financial institutions and governments that facilitated those activities.[22] They advocated the introduction of legislation setting clear norms for companies concerning their impacts on nature and people.

Their claims were not welcomed since in that period, and for a long time thereafter, the political and governance trend was (is) to assume that markets solve those problems. But markets are not perfect: they are not transparent, manipulation is possible through advertisements, greenwashing, lobby, etc., and externalities are not priced. Moreover, it takes a long time before change will have been implemented in whole sector and markets.[23] That is why in 2000, several international codes of conduct addressed to companies emerged prescribing CSR norms, such as the UN Global Compact Principles (2000), the revised OECD Guidelines for Multinational Enterprises (2000), the Global Reporting Initiative (2000), and the Equator Principles for the financial industry (2004). Many more followed. However, as argued, markets do not constitute the perfect instrument to solve unpriced externalities. Although the awareness was growing that the business community has a role to play and responsibility to take, only very few companies redesigned their business model and activities in such a way that they avoid causing adverse impacts on nature and people. Examples can be found among social enterprises that started their operations by defining a purpose aimed at positively affecting nature and/or people. Hence, they designed their business model and activities to fit that purpose.[24] Among larger companies, few examples can be found, e.g., Interface and Patagonia that revised their business model into a circular business model and observe human and labour rights.[25]

3. Circular Business Operations require Due Diligence Investigation

Indeed, the least adverse impact is caused when a company operates in a fully circular manner, and combines that with observing human rights, labour rights and consumer rights, avoiding corruption, and staying away from exercising political influence and misleading marketing. Circular economy is a term employed by many, i.e., the European Commission (it is part of the Green Deal),[26] the Dutch government (e.g., the *Grondstoffen Nota* 2022),[27] and companies.[28] However, in practice, most companies have not reinvented their business model. To fully understand what circular operations mean for a business model, the 'butterfly diagram' designed by the Ellen MacArthur Foundation needs to be examined (figure 4; see page 206).

In order to find out on which raw materials, products, water, energy, and labour, a company depends, it needs to scrutinise its whole value chain: starting with the raw materials and finding out how they have been extracted and transported, the production process, the sales and use phases, and ending with the after-use waste management

18 Porter, M. & Kramer, M., 'Creating Shared Value', *Harvard Business Review* 89, nos. 1-2 (January-February 2011): 62-77. Elkington, J., (1999), *Cannibals with forks: the triple bottom line of 21st century business*, Oxford: Capstone. Lambooy, T.E. (2010), *Corporate Social Responsibility. Legal and semi-legal frameworks supporting CSR*, Kluwer: Deventer, the Netherlands. Elkington, J. '25 years ago I coined the phrase "Triple Bottom Line". Here's why it's time to rethink it', *Harvard Business Review* 25 June 2018; hbr.org/2018/06/25-years-ago-i-coined-the-phrase-triple-bottom-line-heres-why-im-givingup-on-it. Van Tulder, R. & Van der Zwart, A. (2006), *International Business-Society Management – Linking Corporate Responsibility and Globalisation*, Routledge: Abingdon, UK.

19 Lambooy, T. & Rancourt, M.E., 'Shell in Nigeria: From Human Rights Abuse to Corporate Social Responsibility', *Human Rights & International Legal Discourse*, Vol.2, 2008(2), p. 229-275.

20 Greenpeace; www.greenpeace.org/international/story/46877/industrial-fishing-companies-manage-oceans-why/.

21 Banktrack; www.banktrack.org/article/4_out_of_5_banks_failing_on_human_rights_report_shows.

22 Van Tulder, R. & Van der Zwart, A. (2003), Reputaties op het spel. *Maatschappelijk verantwoord ondernemen in een onderhandelingssamenleving*, Spectrum: Utrecht.

23 Simons, L. & Nijhof, A. (2021), *Changing the game*, Routledge: Oxon/New York.

24 Argyrou A. (2018), *Social enterprises in the EU: Law promoting stakeholder participation in social enterprises*, Wolters Kluwer: Deventer, the Netherlands. Examples of social enterprises in the Netherlands can be found at the Register of social enterprises, published by the Code Sociale Ondernemingen; www.codesocialeondernemingen.nl/over-het-register/zoek-deelnemers.

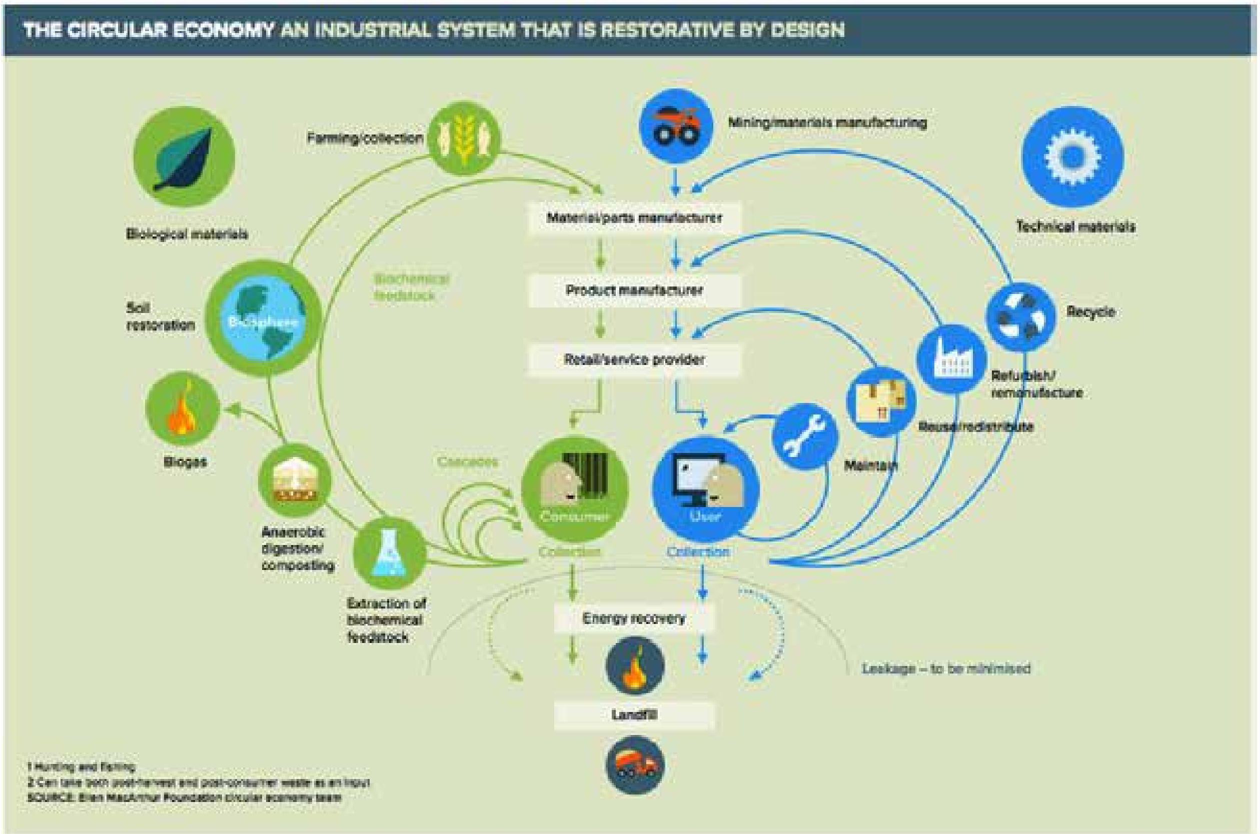
25 Interface, Environmental Commitment; investors.interface.com/corporate-responsibility-esg/environmental/default.aspx. Patagonia, Our Footprint; eu.patagonia.com/gb/en/our-footprint/.

26 The European Green Deal; climate.ec.europa.eu/eu-action/european-green-deal_en; and the EU Circular Economy Action Plan; environment.ec.europa.eu/strategy/circular-economy-action-plan_en.

27 Tweede Kamer, Kamerbrief over Nationale Grondstoffenstrategie, 9 December 2022; open.overheid.nl/documenten/ronl-274460f28f3ac852c957212a344728279206ecdf/pdf. Annex Grondstoffen voor de grote transities; open.overheid.nl/documentenronl-c97cca89a0c360bc012f5d6da3d54dd1844a6d33/pdf.

28 SITA; SITA remains carbon-neutral with circular economy approach – edie. Cyclus; cyclusnv.nl/over-cyclus. Umicore; www.umicore.com/en/. Recover; recoverfiber.com/. Fairphone; www.fairphone.com/nl/story/.

Figure 4. The Butterfly Diagram by the Ellen MacArthur Foundation[29]



of the products of services produced by the company.[30] Only then can a company truly detect its adverse impacts and find ways to reverse them, and to redesign its business model and activities to a circular and fair one.

4. From Substantive Norms to Legal Process Norms: Transparency

4.1 *Transparency about Companies' CSR Policies and Adverse Impacts*

The debate about setting mandatory norms or letting the markets solve the problems continues. An early compromise was to agree upon process norms, e.g., to require companies to be *transparent* in their annual reports about their CSR policies and adverse impacts. Legislative examples in the European Union (EU) are the EU Modernisation Directive (2003),[31] which was amended by the Non-Financial Reporting Directive (2014),[32] and the EU Corporate Sustainability Reporting Directive, which was finalised in 2022 (CSRD; 2022).[33] Comparable provisions can be found in the Dutch Corporate Governance Codes of 2008, 2016 and 2022.[34]

29 Ellen MacArthur Foundation; www.researchgate.net/figure/1-The-Circular-Economy-diagram-From-Ellen-MacArthur-Foundation-2012a_fig10_285596942.

30 See e.g., the EU studies regarding sustainability hotspots in the ready-made garment and mobile telephone international value chains: Lambooy, T., Bosman, M. & Solaimani, S. (2017), *Sustainability Hot Spot Analysis of two ready-made garments*. Report of findings in Work Package 3, Sustainable Market Actors for Responsible Trade (EU SMART); www.smart.uio.no/publications/reports/d3.1.-revised-hotspots-analysis-wp3.pdf; Lambooy, T., Bosman, M., Argyrou, A., Jansen, B., Begum, S. & Kahn, A. (2019), *The Regulatory Ecology of two severe Sustainability Hot Spots in the product life cycles of a pair of jeans and a T-shirt*. Report of findings in Work Package 3, Sustainable Market Actors for Responsible Trade (SMART); www.smart.uio.no/publications/reports/d3.3smartreportregulatoryecologyjeanst-shirt4.4.2019.pdf; and Van der Velden, M. & Taylor, M. (2017), *Sustainability Hotspots Analysis of the Mobile Phone Lifecycle*; www.smart.uio.no/publications/reports/sustainability-hotspots-analysis-of-the-mobile-phone-lifecycle.pdf.

31 Lambooy, T. & Van Vliet, N., 'Transparency on Corporate Social Responsibility in Annual Reports', *European Company Law*, Vol 5, 2008(3), p. 127-135.

32 Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups Text with EEA relevance, *OJ* L 330/1 (2014). Lambooy, T., Hordijk, R. & Bijveld, W. (2013), 'Integrating sustainability in corporate strategy and reporting: The regulatory environment of integrated reporting from an international, European and Dutch perspective', in Jones, B.T. (ed.), *Communicating CSR*, Emerald: UK.

33 Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (Text with EEA relevance), *OJ* L 322, 16.12.2022. See in this special issue the contributions of J.P. Robé, *Ondernemingsrecht* 2023/31, and S.B. Garcia Nelen, *Ondernemingsrecht* 2023/32.

34 Lambooy, T. (2022), 'Verankering van de belangen van toekomstige generaties en de natuur in de governance', in: Claassen, R. & Schoenmaker, D., *Corporate governance en het maatschappelijk belang*, Pre-adviezen van de Koninklijke Vereniging voor de Staathuishoudkunde: Amsterdam, Netherlands.

4.2 *Transparency about the CSR Profile of Investment Funds*

To oblige investors to create transparency concerning the CSR profile of the investee-companies in their investment funds, the EU has adopted the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation.[35]

4.3 *Transparency about CSR at Product Level*

"Reporting on product life cycle impacts is the next step for sustainability reporting" has been argued by many CSOs, investors and politicians.[36] Attempts to introduce legislation regarding CSR transparency at product level failed in the Netherlands (legislative proposal *Wet openbaarheid productie en ketens* 2008).[37] EU legislation does not prescribe such type of disclosure for all products and services offered by companies either. There are specific categories of products that are covered by EU disclosure regulation, such as chemicals. The EU REACH Regulation states that consumers and employees may enquire information from producers, respectively their employers, about the dangers of chemicals in products for health and environment.[38] But this Regulation cannot be seen as legislation providing CSR transparency at product level.

5. From Legal Substantive Norms to Legal Process Norms: Due Diligence

5.1 *Business & Human Rights Due Diligence: The UNGP (Soft Law)*

Another process norm is to require companies to set up a *due diligence system and to conduct due diligence assessments* in regard of CSR issues in their international value chains. This approach was developed by the UN Secretary-General's Special Representative on Business and Human Rights, Professor John Ruggie, and his Business & Human Rights team. They collaborated with companies, CSOs and public actors. Hence, the due diligence obligation to detect human rights violations enjoys legitimatisation from the various parties involved. The 'Ruggie Framework' was presented to the UN in 2008 and endorsed,[39] and followed up in the UN Guiding Principles on Business and Human Rights (UNGP; 2011).[40] The UNGP constitute a soft law instrument applicable to all companies.

5.2 *CSR Due Diligence: The OECD Guidelines (Soft Law)*

The due diligence approach was subsequently copied in the revised 2011 OECD Guidelines for Multinational Enterprises (OECD Guidelines),[41] but with a wider scope, i.e., not only pertaining to human and labour rights impacts but also to environmental impacts. The OECD Guidelines constitute a soft law instrument that applies to all companies based in OECD Member States and adhering countries. Although these Guidelines are soft law, they have certain legal impact because governments require companies to comply with them to participate in procurement processes, and to be eligible for export insurance support and subsidies. Further, they are often referred to in private sector procurement contracts, finance and investment agreements. Moreover, as they represent norms that have been agreed upon in a multi-stakeholder setting – like the OECD Guidelines and the UNGP – they also carry a certain level of legitimacy. The Dutch District Court in the Shell climate case referred to both the OECD Guidelines and the UNGP as relevant for interpreting the standard of care in a tort case (like this one).[42]

5.3 *CSR Due Diligence concerning Timber Products (EU Law)*

The CSR due diligence approach has been adopted in several EU laws. The first was the EU Timber Regulation which prohibits the importing, processing and placing of illegally harvested timber on the market.[43] Companies need to set up a

35 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 and 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.

36 E.g., *Reuters*, Ramon Arratia, news item, 22 January 2013, 'Full product transparency is the future of reporting'; www.reutersevents.com/sustainability/communications-reporting/full-product-transparency-future-reporting. Lambooy, T. & Levashova, Y., 'To know or not to know? The consumer's right to information under Reach and other European Union legislation, *Tijdschrift voor Consumentenrecht & handelspraktijken*, 2010(4), p. 153-163.

37 The proposal is accessible through: MVO Platform, Wet openbaarheid van productie en ketens; www.mvoplatform.nl/wet-openbaarheid-van-productie-en-ketens/.

38 Lambooy & Levashova (2010), supra n. 36.

39 Protect, Respect and Remedy: A framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, A/HRC/8/5 (7 April 2008); ohchr.org/english/bodies/hrcouncil/docs/8session/A-HRC-8-5.doc. See on the roots of the due diligence concept: Lambooy, T., 'Corporate due diligence as a tool to respect human rights', *Netherlands Quarterly of Human Rights (NQHR)*, Vol. 28, 2010(3), p. 404-448. See also in this special issue the contribution of J.P. Robé, *Ondernemingsrecht* 2023/31.

40 Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, A/HRC/17/31 (21 March 2011); ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf.

41 OECD Guidelines for Multinational Enterprises, OECD 2011; dx.doi.org/10.1787/9789264115415-en.

42 Rb. (District Court) Den Haag 26 May 2021, ECLI:NL:RBDHA:2021:5337 (*Milieudefensie e.a./Royal Dutch Shell*). *Opinion*, 29 May 2021, Lambooy, T., 'Shell stumbles over an old open cellar hatch'; www.nyenrode.nl/en/news/n/shell-stumbles. See about the corporate duty of care also: Enneking, L., e.a. (2016), 'Zorgplichten van Nederlandse ondernemingen inzake internationaal maatschappelijk verantwoord ondernemen', WODC-rapport 2531; repository.wodc.nl/handle/20.500.12832/2158; Boomjuridisch: Den Haag. Enneking, L., 'Van beleid naar gepaste zorgvuldigheid in mondiale waardeketens', *NTBR* 2022/43, afl. 10. See in this special issue also the contribution of J.P. Robé, *Ondernemingsrecht* 2023/31.

43 Art. 4 of the Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010 laying down the obligations of operators who place timber and timber products on the market Text with EEA relevance *OJ* L 295, 12.11.2010.

due diligence system capable of ensuring that the risk of illegally harvested timber or derived products reaching the EU market is negligible.[44] They must gather all relevant information and identify, fully assess, and, where necessary, adequately mitigate such risks to a negligible level.[45] Throughout the supply chain, the companies should be able to identify the operators or the traders who have supplied the timber and timber products; and where applicable, the traders to whom they have supplied timber and timber products.[46]

The practical side of it is that operators must put in place a set of procedures, measures and risk criteria in order to identify and assess the risk of sourcing illegally harvested timber or timber products that may contain illegally harvested timber, and, on that basis, exercise due diligence prior to their acquisition.[47] If the conclusion of the risk assessment is that the risk of illegally harvested timber or derived products entering the EU market is non-negligible, the operator needs to take risk mitigation measures that are adequate to lower the risk to a negligible level. If there is no access to the applicable local legislation or other relevant information, the risk cannot be fully assessed and thus not mitigated to a negligible level. If the risk cannot be mitigated to a negligible level, the operator should not place the timber on the EU market.[48]

This Regulation has proved its effectiveness as recently two Dutch importers of teak from Myanmar have been sentenced by a Dutch court (criminal law section) for not complying with their CSR due diligence obligations.[49]

5.4 *CSR Due Diligence regarding Conflict Minerals (EU and US Law)*

In 2021, the EU "conflict minerals" Regulation 2017/821 related to tin, tantalum, tungsten and gold (3TGs), became effective in the EU.[50] This EU law follows Section 1502 of the U.S. Dodd Frank Act that requires responsible minerals sourcing. The motivation behind these laws is explained by the CSO Global Witness: "The trade in natural resources finances conflict and human rights abuses all over the world. For decades the trade in minerals, precious stones, and other commodities has played a central role in fuelling some of the world's most brutal conflicts and weakening already fragile states."[51] Global Witness has exposed links between abuses, fighting, and this trade in the Central African Republic, Myanmar, Afghanistan, the Democratic Republic of Congo, and elsewhere. It also revealed how revenues from the trade in natural resources provides "abusive armed groups the means and incentive to operate and funding to State security forces and corrupt officials hiding behind secretive company structures."[52]

The aim of the EU Regulation is to ensure that European importers of these materials source them from conflict-affected or high-risk areas responsibly. To that end, supply chain due diligence obligations are imposed on EU importers of minerals and metals. They must follow a five-step due diligence framework:

"– Establish strong company management systems.
– Identify and assess risks in the supply chain.
– Design and implement a strategy to respond to identified risks.
– Carry out an independent third-party audit of supply chain due diligence.
– Report annually on supply chain due diligence efforts."[53]

EU Member States had to adapt in their national law the process of control of the enforcement by EU importers of their supply chain due diligence obligation.[54]

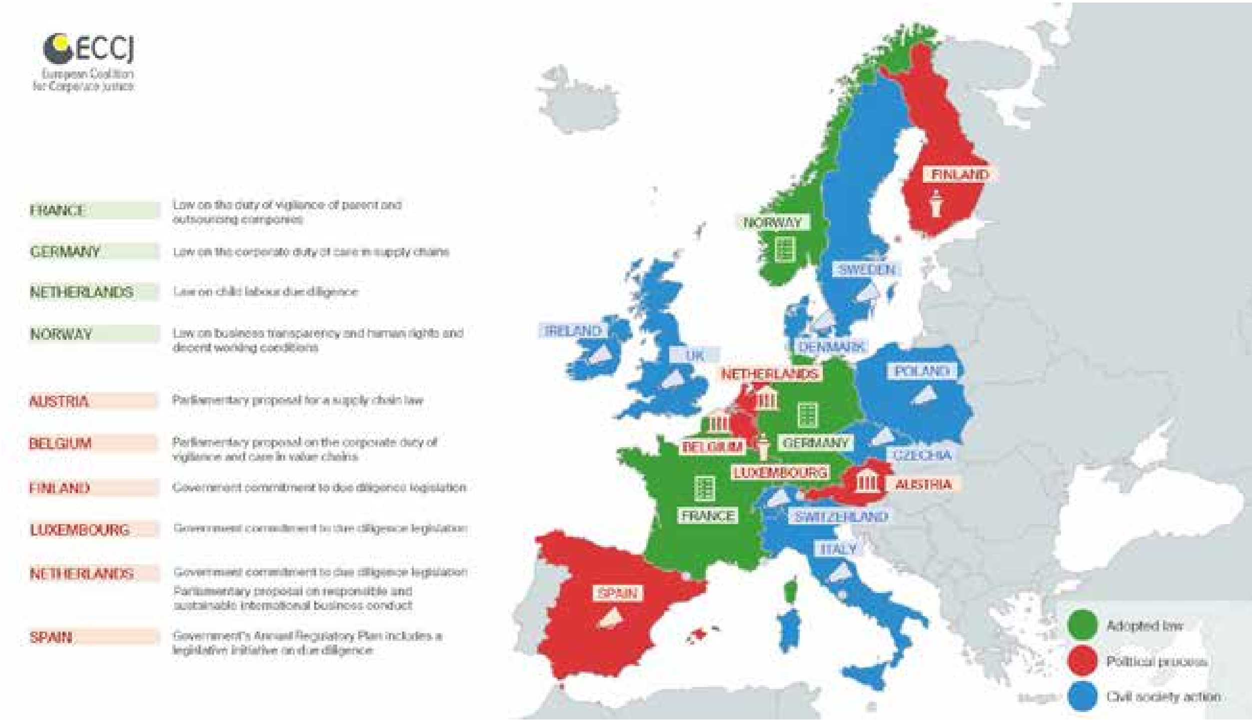
5.5 *CSR Due Diligence Legislation regarding Slavery, Child Labour, Human and Labour Rights and CSR in General (European Jurisdictions – National Laws)*

In 2015, the United Kingdom introduced the Modern Slavery Act. This Act requires corporate disclosures concerning due diligence assessments pertaining to slavery in companies' international supply chains.[55] Two years later, in 2017, France adopted CSR due diligence obligations for large companies in regard of environmental and social risks in their business

44 Art. 4 and 6 of the EU Timber Regulation. See also: Expert Group on the EU Timber Regulation and the Forest Law Enforcement, Governance and Trade (FLEGT) Regulation Guidance document – Due Diligence; ec.europa.eu/environment/forests/pdf/28_02_2020_Guidance_on_Due_Diligence.pdf. And see the EU Commission Guidance document dated 12 February 2016, section 2. Definition of 'Negligible Risk"; ec.europa.eu/environment/forests/pdf/C_2016_755_F1_ACT_EN_V6_P1_831439.PDF.
45 Art. 4-6 of the EU Timber Regulation.
46 Art. 5 of the EU Timber Regulation.
47 Commission Implementing Regulation (EU) No 607/2012 on the detailed rules concerning the due diligence system and the frequency and nature of the checks on monitoring organisations. See also: UK, EU Timber Regulation Guidance Document; www.bwf.org.uk/latest-news/eu-timber-regulation-guidance-document-launched-to-cover-due-diligence-systems/.
48 Expert Group on the EU Timber Regulation and the Forest Law Enforcement, Governance and Trade (FLEGT) Regulation Guidance document – Due Diligence; ec.europa.eu/environment/forests/pdf/28_02_2020_Guidance_on_Due_Diligence.pdf.
49 *NRC* 13 December 2022, 'Import teak uit Myanmar veroordeeld'. Rb. (District Court) Amsterdam 12 December 2022, ECLI:NL:RBAMS:2022:7442.
50 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.
51 Global Witness; www.globalwitness.org/en/campaigns/conflict-minerals/dodd-frank-act-section-1502/.
52 Idem.
53 Stream, Advocats & Solicitors, 'EU Regulation 2017/821 – New due diligence obligations of EU based importers of tin, tantalum, tungsten and gold', 3 November 2021; stream.law/en/eu-regulation-2017-821-new-due-diligence-obligations-of-eu-based-importers-of-tin-tantalum-tungsten-and-gold/.
54 Idem.
55 Legislation, UK government, Modern Slavery Act 2-15; www.legislation.gov.uk/ukpga/2015/30/contents/enacted. Section 54(5)(c) on due diligence.

operations and international value chains.[56] Although the Netherlands adopted CSR due diligence obligations regarding child labour in international supply chains in 2019, the law has yet not become effective.[57] Germany adopted a law on international CSR supply chain due diligence obligations in 2021, which law came into force on 1 January 2023.[58] Also in 2021, Norway introduced a law on business transparency on human rights and decent working conditions, also pertaining to international supply chains.[60] This Act became effective on 1 July 2022. Thus, by the beginning of 2023, several European jurisdictions have adopted corporate CSR due diligence obligations inspired by the UNGPs and the OECD Guidelines aimed at detecting CSR risks in their international value chains. Furthermore, in five jurisdictions, processes to adopt legislation are on-going and in eight jurisdictions civil society is demanding action. See figure 5.

Figure 5. Map European Legislation on CSR Due Diligence[59]



6. Upcoming Legislation: The EU Corporate Sustainability Due Diligence Directive

6.1 *Developments and Background of the CSDDD*

Referring to the OECD Guidelines and the UNGP, in February 2022, the EU Commission introduced a draft text (the Commission Proposal) of the Corporate Sustainability Due Diligence Directive (CSDDD).[61] Following this publication by the Commission, the European Parliament's Committee on Legal Affairs published on 7 November 2022 a Draft Report (the Draft Wolters Report), which is not yet finally approved by the Legal Affairs Committee.[62] On 1 December 2022, the European Council formally adopted its negotiating position on the CSDDD and published several amendments (the Political Compromise).[63] The Political Compromise completes the negotiating position agreed by the

56 Law on the duty of vigilance of parent and outsourcing companies. Loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuse' d'ordre. See in this special issue also the contribution of J.P. Robé, *Ondernemingsrecht* 2023/31.

57 Business & Human Rights Resource Centre, 'Dutch child labour due diligence law: a step towards mandatory human rights due diligence', 10 June 2019; www.business-humanrights.org/en/latest-news/dutch-child-labour-due-diligence-law-a-step-towards-mandatory-human-rights-due-diligence/.

58 Business & Human Rights Resource Centre, 'German parliament passes mandatory human rights due diligence law', 16 June 2021; www.business-humanrights.org/en/latest-news/german-due-diligence-law/.

59 European Coalition for Corporate Justice; corporatejustice.org/wp-content/uploads/2022/01/ECCJ-mHREDD-map-January-2022.pdf.

60 DLA Piper, 'New Act regarding transparency of companies compliance to fundamental human rights and working conditions', 29 June 2021; norway.dlapiper.com/en/news/new-act-regarding-transparency-companies-compliance-fundamental-human-rights-and-working.

61 Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, COM/2022/71 final (23.2.2022).

62 Theron, C., 'Proposed EU Directive on Corporate Sustainability Due Diligence: EU Committee of Legal Affairs proposed amendments to the Draft Directive: key change', *Linkedin*, 13 November 2022; www.linkedin.com/pulse/proposed-eu-directive-corporate-sustainability-due-colleen/. European Parliament, Briefing, 'Corporate sustainability due diligence Could value chains integrate human rights and environmental concerns?', May 2022; www.europarl.europa.eu/RegData/etudes/BRIE/2022/729424/EPRS_BRI(2022)729424_EN.pdf.

63 The Council of the European Union, Interinstitutional File: 2022/0051, 30 November 2022: 'Council general approach on the Directive on corporate sustainability due diligence'; data.consilium.europa.eu/doc/document/ST-15024-2022-REV-1/en/pdf. European Council, 'Council adopts position on due diligence rules for large companies', Press release 1 December 2022; www.consilium.europa.eu/en/press/press-releases/2022/12/01/council-adopts-position-on-due-diligence-rules-for-large-companies/.

Council. It provides the Council presidency with a mandate to start negotiations with the European Parliament. The Draft Wolters Report will be part of such negotiations.

The CSDDD has been introduced with the aim to support the EU in reaching its climate and sustainability goals and in ensuring the protection of human rights.[64] The Commission Proposal specifically mentions the EU transition towards a more climate-neutral and green economy as described in the European Green Deal and the UN Sustainable Development Goals. To realise those objectives, the EU considers it important to oblige large companies (i) to adopt a plan ensuring their business model and strategy are compatible with the Paris Agreement[65] and (ii) to set up effective due diligence systems in order to identify, prevent, mitigate and redress actual and potential adverse impacts on human rights and the environment.[66] The due diligence obligation relates to a company's own operations, those of their subsidiaries, and those carried out by their business partners.[67] Rules on penalties and civil liability for violating those obligations are also part of the CSDDD.[68]

The other contributions in this special issue elaborate in depth on the various new obligations covered by the CSDDD, and the textual variations of those obligations as they are stated in the Commission Proposal, the Political Compromise and the Draft Wolters Report.[69] One of those variations pertains to the duty of care of corporate directors for the due diligence process and the overall sustainability strategy, as included in the Commission Proposal. Mieke Olaerts discusses this topic in depth.[70] In addition to her contribution, some more reflections are offered below.

6.2 *The Discourse concerning the Directors' Duty of Care*

Article 25 of the Commission Proposal provides for a directors' duty of care. The provision prescribes that directors take into account the consequences of their business decision for sustainability matters, including, where applicable, human rights, climate change and environmental consequences in the short, medium and long-term. They must set up systems integrating due diligence into the corporate strategy. Closely linked thereto is Article 26 of the Commission Proposal. See box 1 for the text of the Articles 25 and 26 of the Commission Proposal. The Political Compromise however deleted those provisions, arguing "Due to the strong concerns expressed by Member States that considered Article 25 to be an inappropriate interference with national provisions regarding directors' duty of care, and potentially undermining directors' duty to act in the best interest of the company, the provisions have been deleted from the text."[71] Instead, the Political Compromise requires companies (not directors) to put in place and oversee the actions required to fulfil the due diligence obligations.

Taking out the director's duty of care – as proposed in the Political Compromise – concerns a very material change and affects one of the backbones of the CSDDD. Indeed, setting a clear norm for the directors makes it important for them to really implement the new rules. This is what became clear from anti-corruption laws in jurisdictions such as the United States (US) and the United Kingdom (UK).[72] In regard of the US anti-corruption law enforcement, it has been stated by US officials in 2019 that an "individual accountability policy is designed to drive change, and lead more companies to implement meaningful proactive compliance programs".[73] Also, the US Securities and Exchange Commission (SEC) "has long considered individual liability a "core principle" of FCPA enforcement".[74]

When prosecuted pursuant to US or UK anti-corruption laws, companies and their directors defended themselves by stating that they had set up an adequate due diligence system to detect and prevent the paying of bribes by their employees or agents and that they personally could not be

64 CSDDD, the Commission Proposal, Preamble. See in this special issue also the contribution of S.B. Garcia Nelen, *Ondernemingsrecht* 2023/32.
65 Art. 15 of the CSDDD, the Commission Proposal.
66 Art. 4-11 of the CSDDD, the Commission Proposal.
67 Art. 3(g) of the CSDDD, the Commission Proposal: '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.
68 Art. 17-22 of the CSDDD, the Commission Proposal.
69 See also the recent analysis of the variations between the three texts produced by White & Case; 'Due Diligence in Supply Chains – Update on corporate human rights and environmental due diligence requirements in the EU and Germany'; www.whitecase.com/insight-alert/due-diligence-supply-chains-update-corporate-human-rights-and-environmental-due.
70 M. Olaerts, *Ondernemingsrecht* 2023/38.
71 The Political Compromise, supra n. 63, under no. 31, p. 8.
72 US: Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended at 15 U.S.C. §§78dd-1-3(2000); www.justice.gov/criminal/fraud/fcpa/. The anti-bribery provisions of this Act make it unlawful for American individuals and companies (and those foreigners or companies who/which have a functional connection with the US) to pay bribes to non-US government officials for the purpose of obtaining or retaining business. Officers and directors may be liable for violations of the anti-bribery provisions if they are in fact the wrongdoers (engaging in, directing others to engage in, or concealing FCPA violations), or if they turn a blind eye to a wrongful payment (or pattern thereof) under the FCPA (i.e., willful blindness, deliberate ignorance, or conscious disregard).
73 Carter/Ledyard, 'FCPA Liability and Best Practices for Directors and Officers', 24 June 2019; www.clm.com/fcpa-liability-and-best-practices-for-directors-and-officers/.
74 Idem. The quote was articulated by the SEC's Co-Director of Enforcement in December 2017: "As [SEC] Chairman Clayton observed at his confirmation hearing, individual accountability drives behavior more than corporate accountability, a point which is supported by both logic and experience. The Division of Enforcement considers individual liability in every case it investigates; it is a core principle of our enforcement program."; www.sec.gov/news/speech/speech-peikin-2017-11-09.

blamed.[75] Many anti-corruption laws treat corruption as a strict liability offence, or one requiring only minimal knowledge. Because of this, organisations allocated ample resources to prevent and mitigate potential liability that can arise from interactions with and reliance upon third parties.[76] In other words, to avoid being held liable for corrupt third-party payments, companies were encouraged to exercise due diligence and to take all necessary precautions.[77]

The original intention of the CSDDD (as set out by the European Parliament and as has been reflected in the consultation process), was twofold in service of meeting the ambitions of the EU Green Deal. Firstly, to provide a regulatory framework to an overarching duty of care by directors to make corporate governance more sustainability-oriented. Secondly, to embed due diligence obligations for companies in their international value chains. The Commission Proposal placed the emphasis on due diligence obligations in Article 25 but also addresses the broader concept of a directors' duty of care. Whilst fully recognising the importance of a director's consideration of due diligence in value chains, this focus does not provide a complete picture of a business's impact on the world in which it operates. A directors' duty of care underpins the ripple effect of the due diligence requirements, whilst widening the lens to consider the impact on sustainability issues in decisions that businesses need to take in running their operations.

This point was repeatedly made by B Lab and the Interdependence Coalition.[78] The global group of over 6,200 certified B Corps and many social enterprises in Europe have voluntarily included in their incorporation documents and articles of association the obligation for directors to consider the impact of their decisions on all those affected by its operations. Those companies have for years proven the concept that running a business in consideration of the broader impact on people and planet can be in a business's best interests too. B Lab and the Interdependence Coalition substantiate their support of a directors' duty of care for sustainability by pointing at:

(i) a robust competitive revenue growth of companies (in Europe, up to 30% annual growth on average amongst B Corps);[79]
(ii) an increased interest from high quality applicants followed by high levels of staff motivation and retention;[80]
(iii) an improved access to and lower cost of capital;[81] and they state that
(iv) other anecdotal and internal data suggest that B Corps have been more robust in contributing to community needs and withstanding the effects of COVID (with fewer layoffs and bankruptcies).[82]

The chances of meeting the ambitious and much needed goals of the EU Green Deal are enhanced enormously with the inclusion of Article 25 in the CSDDD, as this provision can function as the 'Northern Pole Star' in the implementation by companies. Further, Article 26 supports this. Given this, they merit their place in the CSDDD.

75 Lambooy, T.E. (2010), ***Corporate Social Responsibility. Legal and semi-legal frameworks supporting CSR***, Kluwer: Deventer, the Netherlands. See chapter 5. 'Corruption and corporate governance: 'in control' requires an anti-corruption programme', p. 171-226. See further: the UK Bribery Act 2010 and Guidelines; www.gov.uk/anti-bribery-policy. See also: J. Spinelli (Daylight Forensic & Advisory), 'Foreign Corrupt Practices Act Due Diligence in Mergers & Acquisitions', Ethisphere TM Institute (online news service), 13 May 2009; ethisphere.com/foreign-corrupt-practices-act-due-diligence-in-mergers-acquisitions/. This paper illustrates that extensive FCPA due diligence is needed when operating in a high-risk industry (e.g., oil), in high-risk countries and in deals with government-owned organisations. Huskins, P. (2008), 'FCPA Prosecutions: Liability Trend to Watch', in Stanford Law Review, Vol. 50, No. 5; www.stanford.edu/group/lawreview/content/vol60/issue5/Huskins.pdf. Low, L.A. (2005), 'Enforcement of the FCPA in the United States: Trends and the Effects of International Standards, International Bar Association', 3rd Annual Conference 'The Awakening Giant of Anti-Corruption Enforcement', Paris, 4-6 May 2005. OECD, 'Steps taken by State Parties to implement and enforce the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions', www.oecd.org/document/44/0,3343,en_2649_34859_36433004_1_1_1_1,00.html.

76 It is necessary to conduct enhanced due diligence on third party intermediaries in the context of the Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act 2010. Due diligence is often cited as a 'must have' for any compliance program. The US DOJ and the SEC, and the UK's Serious Fraud Office aim to tighten the noose around overseas corruption, as such, the perceived level of due diligence will become more onerous; www.corporatecomplianceinsights.com/what-does-anti-corruption-due-diligence-really-mean/; and ethixbase.com/.

77 Donovan & Ho, Director Due Diligence, 'Corporate Liability for Corruption: What should HR do?'; dnh.com.my and diligent.com. See also: De Schutter, O., 'The prevention of corruption as part of mandatory due diligence in EU legislation', Report prepared at the request of Transparency International EU and Global Witness, April 2021; transparency.eu/wp-content/uploads/2021/04/Web_The_Prevention_of_Corruption_Due_Diligence_EU-Legislation.pdf.

78 B Corp; Reaction paper of the Interdependence Coalition. Proposal for a Directive on corporate sustainability due diligence (CSDD); bcorp.imagerelay.com/share/ae7cbf7f78d64f27ba7ab6b9c27cc5fa.

79 Idem. See references in note 5 thereof (B Lab Europe's own internal data analysis of European B Corps that have recertified at least once (required every three years) (B Lab Europe, 2022)) and note 7 (B Lab Global's 2021 Annual Report), p. 10.

80 Idem, see slide 5 and reference 6 (Yeuseung Kim, 'Certified Corporate Social Responsibility? The Current State of Certified and Decertified B Corps', ***Corporate Social Responsibility and Environmental Management*** 28, no. 6(2021): 1760-68. See further: B Corp UK. Home; ourstory.bcorporation.uk//.

81 See e.g. (B Lab's own research): ThenDoBetter, '2bn Loan Tied to ESG Matrics', dated 25 February 2018, concerning Danone debt finance; www.thendobetter.com/investing/2018/2/25/esg-metrics-tied-to-loan-danone; and PZ Cussons recent debt mechanism where cost of capital is inversely related to its ESG score as measured by the B Corp's Impact assessment; www.pzcussons.com/wp-content/uploads/2022/11/PZ-Cussons-RCF-RNS-vFinal.pdf.

82 Poole College of Management News, 'In an economy ravaged by COVID-19, B Corps open a door for change', 1 June 2020; poole.ncsu.edu/news/2020/06/01/need-to-know-in-an-economy-ravaged-by-covid-19-b-corps-open-a-door-for-change/.

Box 1. CSDDD Commission Proposal dated February 2022

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.

7. Conclusion

In this contribution, the background has been sketched for introducing CSR due diligence. As has become evident from the Planetary Boundaries, Intergovernmental Panel on Climate Change and WWF studies, we need to reform our economic system. We don't have much time to realise that change. The sooner the better as more and more Planetary Boundaries are being transgressed, which soon will lead to the implosion of whole ecosystems and biophysical processes. Governments as well as companies and citizens have a role to play and are to take responsibility for initiating and implementing change. Companies need to redesign their business models and activities towards circularity to act upon the insights gained from the Planetary Boundaries. At the same time, they also must set up due diligence systems to ensure they avoid violating human and labour rights. First of all because this has been agreed in many international treaties, guidelines and other regulation. Secondly, on a more personal level, the premise is that most people would like to strive to limit their negative impact, including as resulting from their work or business activities.

The key message of the CSDDD is to apply due diligence in all business operations and international value chains. Making changes to business-as-usual takes efforts and entices resistance. Many companies, their legal advisers and lobbyists, employers' and sectors' organisations, try to convince the legislators not to adopt legislation that might require change. Or to soften it, i.e., to make it less effective in practice. However, companies are generally very adept at addressing change and new challenges, e.g., developing and implementing new software and expanding business operations to new foreign markets. Why not take this step forward?

It appears that the aim of ensuring business activities have negligent adverse impact on the environment and human rights is imminently worthwhile. It is easy as a lawyer to criticise new legislation such as the CSDDD. Many lawyers mainly see the positive law with which they work. To change our economy, many steps need to be taken and implementing new laws to enshrine new norms is one important step. Ultimately, it will take many years if not decades before those new laws and norms have been really implemented and are seen as business as usual. The discussion about corporate transparency as stipulated by the CSRD began approximately 25 years ago, the discussion about CSR due diligence in 2008, 15 years before the CSDDD is being discussed today. It would be good if lawyers and other advisers take up the role of supporting new sustainability legislation such as the CSDDD and finding answers to emerging problems, e.g., with open norms, along the way. The CSRD is a beginning, the CSDDD and national CSR due diligence laws constitute a second step, and very soon the next step needs to be taken and that is adopting norms on circular economy – for every company and institution. The CSRD and the CSDDD do not provide for norms that boost circular economy, so we need to move on. Keep up the good work legislators!

The simple and basic idea is that a company should take responsibility for its adverse impacts. And performing due diligence in its international value chains is a necessary step for a company to be able to take responsibility for its adverse impacts.

Jean-Philippe Robé[1]

Steering Towards Sustainability

Ondernemingsrecht 2023/31

The article summarizes the main rules contemplated by the draft CSDDD. It builds on scientific evidence to underline the seriousness of environmental decay and the need for appropriate legal rules to correct issues created by the present-day private legal structuring of the world economy. The article further shows that prevailing so-called law and economics analyses misrepresent existing biases in corporate management which create issues traditionally addressed by externality regulation. In a globalized economy, however, better externality regulation is not a realistic option, and it is in the management of global firms that changes must occur. Member States have started enacting legislation to address these issues (the French example is presented in the article) and courts are also playing their law-making role. The CSDDD will provide a level playing field which must be both ambitious and realistic.

1. Introduction

On 23 February 2022, the European Commission made public a proposed Directive on corporate sustainability due diligence ("CSDDD"). The text of the CSDDD is still being considered by the EU's co-legislators: the European Parliament and Council. Consensus is missing, and it is questionable whether an agreement between Parliament and Council is achievable ahead of the European Parliament elections in the spring of 2024.

At the date of finalising this article, the Parliament's Committee on Legal Affairs – in charge of the Parliament's negotiations on the CSDDD – published a draft report on 7 November 2022 (the "Draft Wolters Report") which, however, is not yet finally approved by the Committee. On 1 December 2022 the Council agreed to its negotiating position (the "Political Compromise") for deliberations with the Parliament. The Council must now wait for the Parliament to reach an agreed position before negotiating a final text. The marked ambitious tone of the Draft Wolters Report contrasts with the more conservative position expressed in the Political Compromise and it is likely that there will be significant areas of contention both in the Parliament and with the Council before a common position can be agreed.

1 Jean-Philippe Robé is a member of the New York and Paris bars and teaches at the SciencesPo Law School.

2. The Main Contemplated Rules

The draft CSDDD provides for a set of new rules to address the potentially adverse effects of the activities of large enterprises over the natural environment and human rights.[2] Large companies[3] ("Companies") will be under a duty to conduct, at least on a bi-annual basis,[4] a due diligence of their activities, those of their subsidiaries[5] and of related entities.[6] This due diligence exercise shall inform all the corporate policies of the Companies via the elaboration of a code of conduct and processes to implement the outcome of the due diligence and the verification of compliance.[7] Companies will be under a duty to bring actual adverse impacts to an end.[8]

Specific provisions are provided with regards to climate change. The largest Companies will have to adopt a plan ensuring that their business model and strategy are in line with the Paris Agreement and the objective of achieving climate neutrality by 2050.[9]

The CSDDD provides rules regarding the civil liability attached to the newly created obligations.[10] Also, provisions are contemplated to cover the appropriate Directors' duty of care.[11] This has been dropped in the Political Compro-

2 Article 1.
3 Article 2. The Political Compromise reflects the Commission's proposed CSDDD thresholds with only minor changes. In contradistinction, the draft Wolters Report suggests bringing more companies within the scope of the CSDDD.
4 Article 10.
5 Article 4a.
6 The Political Compromise changed the scope of the due diligence obligations in the proposed CSDDD from a full life-cycle concept of "value chain" to a more limited "chain of activities". The focus is put on a company's upstream and downstream supply chain, including distribution, but expressly excludes the use of products by consumers. The draft Wolters Report favours a larger scope and refers to the "whole value chain approach".
7 Article 5. In the Political Compromise, the mapping of the activities subject to due diligence can be done on a risk basis to prioritize addressing the most severe issues; something which was missing in the Commission's initial draft and was widely criticized.
8 Article 8.
9 Article 15.
10 Article 22. The Political Compromise provides that a company would be liable for damage caused to a natural or legal person by its intentional or negligent failure to abide by the CSDDD. The draft Wolters Report favours strict liability and provides for the potential liability of parent companies for their subsidiaries causing or contributing to an adverse impact.
11 Article 25.

mise.[12] The draft Wolters Report, however, takes the opposite view of strengthening these provisions.

3. Is There an Issue?

Many analysts question the wisdom of the CSDDD or even condemn the effort altogether. For some, with regards to the provisions addressing climate change in particular, no action is needed. They deny the mere existence of the issue. For a "Group of Nordic Company Law Scholars", for example,

> "the problem of climate change … is not the only problem facing us [and] there is no urgency or imminent threat of human extinction or planetary collapse. This is not what science is saying".[13]

Suffice, however, to mention the 5 April 2022 press release of the Intergovernmental Panel on Climate Change ("IPCC"):[14]

> "The evidence is clear: the time for action is now …. We are at a crossroads. … limiting warming to around 1.5°C requires global greenhouse gas emissions to peak before 2025 at the latest. … it is now or never. Without immediate and deep emissions reductions across all sectors, it will be impossible."

In addition, climate change is not the only urgent global environmental issue to be addressed. A concept of "planetary boundaries" not to be exceeded was defined in 2009 by an international team of scientists, led by Johan Rockström and Will Steffen.[15] For each limit, an indicator and a threshold value were estimated in quantities emitted or extracted from the environment. In 2022, six of these limits are considered to have been exceeded.[16]

As a result of exceeding these limits, many scientists believe that we are changing geological eras. From the Holocene, we may have entered the Anthropocene.[17] We thus discover that human activity has the power of a geological force and that this activity is seriously out of step with the preservation of the natural environment that makes it possible.

This is "*what science is saying*". This is what lawyers, among others, must internalise in their analyses of the required changes to be brought to the legal system as a consequence.

4. Is the CSDDD Anti-Markets?

Immediately after the denial of the seriousness of the issue and the urgency of its treatment come arguments drawn from market fundamentalism. For another group of "Nordic and Baltic Company Law Scholars", for example

> "the climate plan … understood as a way of steering business decisions … is highly criticisable. It is questionable if such a mechanism belongs in any market economy."[18]

These commentators simply forget the lesson of one of the best economists ever, Kenneth J. Arrow, who wrote:

> "… [although] efficiency can be achieved through a particular kind of social system, the price system (…) there are profound difficulties with the price system, even, so to speak, within its own logic, and these strengthen the view that, valuable though it is in certain realms, it cannot be made the complete arbiter of social life. (…) in a strictly technical and objective sense, the price system does not always work. You simply cannot price certain things. A classical example (…)

12 It was originally contemplated that the directors' duty of care in the direction of corporate affairs would be extended to require them to (a) set up and oversee the due diligence actions and (b) adapt the corporate strategy to take into account the adverse impacts and adopted due diligence measures. This has been completely deleted in Political Compromise. The explanation given is that this was "*potentially undermining directors' duty to act in the best interest of the company*". (*See* the note from the Permanent Representative Committee (Part 1) to the Council dated November 30, 2022, #30.) This gets one worried that, for the Council, adapting the corporate strategy to address adverse human rights and environmental impacts could go against "*the best interest of the company*". For the Council, there seems to be room for weighting interests even when human rights and the preservation of a liveable planet are at stake; and it can be decided to put shareholders first.

13 https://mafr.fr/media/assets/ouvrages/nordic-analysis-of-company-law-octobre-2020.pdf, p. 5.

14 As a reminder, the IPCC is an organization of governments that are members of the United Nations or WMO. The IPCC currently has 195 members. Thousands of scientists from all over the world contribute to the work of the IPCC which mission is to provide governments at all levels with scientific information that they can use to develop climate policies.

15 Steffen Will et al., *Planetary Boundaries: Guiding human development on a changing planet*, 347 (6223) Science, p. 736 (2015).

16 These are (1) climate change, (2) the integrity of the biosphere (biodiversity, the current rate of global species extinction being one hundred to one thousand species out of a million per year), (3) the disruption of the biochemical cycles of nitrogen and phosphorus (resulting from intensive agriculture and livestock), (4) changes in land use (excessive loss of forests), (5) the introduction of new entities into the environment (heavy metals, synthetic organic compounds, radioactive compounds), and (6) excessive use of fresh water.

17 Paul J. Crutzen, *Geology of Mankind*, 415 Nature, p. 23 (2002).

18 Paul Krüger Andersen, Niklas Arvidsson, Gintautas Bartkus, Andri Fannar Bergthórsson, Virginijus Bitė, Søren Friis Hansen, Jesper Lau Hansen, Svante Johansson, Morten Kinander, Mårten Knuts, Erik Lidman, Troels Michael Lilja, Paulius Miliauskas, Matti J. Sillanpää, Gustaf Sjöberg, Daniel Stattin, Therese Strand, Rebecca Söderström, Steen Thomsen, Veikko Vahtera, Seppo Villa, Andres Vutt, Margit Vutt & Jessica Östberg, ***Response to the Proposal for a Directive on Corporate Sustainability Due Diligence by Nordic and Baltic Company Law Scholars*** (June 7, 2022). Nordic & European Company Law Working Paper No. 22-01, Available at SSRN: https://ssrn.com/abstract=4139249. For a radically different "Nordic" view, ***see*** Beate Sjåfjell & Jukka Mähönen, ***Corporate Purpose and the EU Corporate Sustainability Due Diligence Proposal,*** https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/02/corporate-purpose-and-eu-corporate-sustainability-due-diligence.

> is the pollution of water or air. (…) from the point of view of efficiency as well as from the point of view of distributive justice, something more than the market is called for."[19]

It is hard to consider that Arrow was anti market. But considering that markets are proper instruments to harness when they work does not imply being blind to the need for "*something more*" when they don't. A market economy requires more than markets.

Historically, that "*something more*" has been brought, to varying degrees, by the rules created by certain States, protecting human rights, addressing negative externalities, and reducing inequalities.

In the present-day world economy, however, there are States which do not provide the "*something more*" required by markets to properly operate. There are failed States, and their populations are suffering from the exploitation of their lack of local effective, enforceable, rights.

Also, with regards to the breach of the planetary boundaries, there is a fundamental problem with the concept of "externality". The notion of externality is supposed to be something of minor importance, an accessory negative impact linked to an economic transaction which may need to be addressed but which does not justify prohibiting the underlying transaction altogether. When the "externality" is a life-threatening breach of several planetary boundaries to the point that we are changing geological period, however, we are faced with something which is qualitatively different. The concept of "externality" is not up to the task.

For the same group of "Nordic and Baltic Company Law Scholars", however, the CSDDD is not required because "*evidence suggest that shareholders and equity financing drive the green transition*". And the corporate governance proposals "*are not only unsubstantiated by available empirical evidence on corporate behaviour, but also refuted by what we know*".

5. "What We Know"

In terms of "*what we know*", one of the best experts is Leo Strine. Strine served on the Delaware Court of Chancery[20] as vice chancellor from 1998 to 2011 and chancellor from 2011 to 2014, and as the chief justice of the Delaware Supreme Court from 2014 to 2019.[21] He is also an academic and a law practitioner. His phrasing of "*what we know*" is highly relevant and quite different from the one of the "Nordic and Baltic Company Law Scholars":

> "Under the current legal rules and power structures within corporate law, it is naïve to expect that corporations will not externalize costs when they can. It is naïve to think that they will treat workers the way we would want to be treated. It is naïve to think that corporations will not be tempted to sacrifice long-term value maximizing investments when powerful institutional investors prefer short-term corporate finance gimmicks. … And it is naïve to think that institutional investors themselves will behave differently if action is not taken to address the incentives that cause their interests to diverge from those of the people whose funds they invest. … we must recognize that directors are increasingly vulnerable to pressure from activist investors and shareholder groups with short-term objectives, and that this pressure may logically lead to strategies that sacrifice long-term performance for short-term shareholder wealth."[22]

For Strine, the fundamentalists' belief in markets and classical corporate governance is ill-placed. States must intervene and provide the "*something more*" Arrow was claiming is necessary. As Strine writes,

> "strong and effective externality regulation is important because the profit-pressure put on corporations by institutional investors is strong. … stockholders will put pressure on corporate managers to seek as much profit as they can within the range of legally permissible conduct."[23]

"*What we know*" is thus clearly that it is naïve not to realise that stock market pressure leads to an externalisation of costs and that something needs to be done about it. And it goes beyond naivety to think that "*shareholders drive the green transition*".

6. The Shrinking Room for Externality Regulation

In a global economy without effective global authority there is, however, a structural issue with the proposed creation of "externality regulation". Strine has personally witnessed from the closest possible position the effective operation of the corporate world for decades. But given the global nature of the issue, "*externality regulation*" is not a realistic option. For Strine,

19 *The Limits of Organization*, New York, WW Norton & Co. (1974), pp. 20-23.

20 "*The Delaware Court of Chancery is widely recognized as the nation's preeminent forum for the determination of disputes involving the internal affairs of the thousands upon thousands of Delaware corporations and other business entities through which a vast amount of the world's commercial affairs is conducted. Its unique competence in and exposure to issues of business law are unmatched.*" E.g., https://courts.delaware.gov/chancery/.

21 Delaware hosting 64% of the corporations controlling Fortune 500 enterprises.

22 Leo E. Strine Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, University of Pennsylvania Law School, Institute for Law and Economics, Research Paper N° 15-08 (2015), p. 38.

23 Leo E. Strine Jr., *supra*, pp. 33-34.

> "if interests such as the environment, workers, and consumers are to be protected, then what is required is a revival of effective externality regulation that gives these interests more effective and timely protection. Critically, this externality regulation must be undertaken on a more global scale to match the regulatory structure to the scope of corporate conduct's impact in a globalizing economy."[24]

But this is where the major structural issue of our time resides: the institutions "*to match the regulatory structure to the scope of corporate conduct's impact in a globalizing economy*" are non-existent. "*A revival of effective externality regulation … on a more global scale*" is thus not a realistic option: there is nothing to revive. It is simply not possible to expect global externality regulations (adopted and enforced by whom?) to counterbalance the negative effects of the shareholder value ideology and agency theory based on "quasi-law and economics" notions.[25] We do not have the institutions to reconnect global autonomous enterprises to the political issues they raise.

The sheer reality is that we are living in a global economy with global issues and a shortage of institutions to effectively address them.[26] Our present-day global economy was made possible by a complex legal system allowing participants in this economy to legally structure it – in the "private" sphere of the legal system. In the world power system in place today, external sovereignty allocates power as a matter of principle to States. International public law is theoretically neutral towards the mode of organisation of the internal power system of the various States composing the State System. They have constitutional autonomy.[27] But liberalism was embedded in the post-World War II Bretton Woods system which structurally constrained States adhering to its institutions.[28] After having created the legal conditions for the development of market economies internally,[29] powerful Western States created the multilateral norms and institutions making it possible for markets to spread globally. Tariffs, quotas, and non-tariff barriers were progressively reduced and, in some cases, eliminated. Via treaties and international organisations such as the IMF enforcing the "Washington consensus", States were subjected to a form of "new constitutionalism" limiting their ability to diverge from the tenets of a "market economy" as understood by neoliberals.[30] Consequently, global "multinational" firms obtained the creation of a legal framework enabling them to spread globally. Via a series of treaties leading to an almost free circulation of goods, capital, and services (but not people), a world economy open for private expansion has been legally built.

The autonomous operation of private actors in our global economy certainly generates positive outcomes in terms of reduced prices and economic development. But it also contributes, *inter alia*, to environmental decay, a redirection of economic activities towards lenient jurisdictions and abyssal inequality. And there are no effective institutions and procedures available to reconnect issues to be addressed politically to the economic decisions made by these global economic private organisations. The existing States System, fragmented opposite globally integrated "private" economic organisations, is clearly under stress and needs to enrol private world governments to achieve ends in cannot reach by itself.

To develop the rules and institutions to address these issues, lawyers must lift their game in the analysis of the global polity and in the identification of the legal instruments available to address global issues. The timing issue is such that any radical change in our existing political institutions is excluded. A major constraint to the identification of possible avenues of change is thus to offer ways which must be *both* radical *and* within the overall framework of existing rules structuring the world economy. There is no time to start from scratch.

7. What Should Count

Within the available tools, there are very few instruments which can be used in the not-too-distant future to address the issues created by global business firms. At the UN level, as we have seen, no binding instrument has been adopted after more than 50 years of negotiations. The Global Compact and the Guiding Principles (GP) are non-binding. And the negotiations on a binding instrument, which resumed in 2014, have only led so far to the issuance, in August 2021, of a third draft treaty on a "*Legally Binding Instrument to Regulate, in International Human Rights Law, the Activities of Transnational Business Corporations and other Business Enterprises*".[31]

One of the available instruments which could have a rapid effect is reporting. Strikingly, the CSDDD will interact with

24 Leo E. Strine Jr., *supra*, pp. 39-41. Emphasis added.

25 Notions such as "shareholders own corporations or firms" (they own shares), "directors are the shareholders' agents" (they are agents of the corporation), "shareholders are residual claimants" (the corporation is the residual claimant), "shareholders invest in companies" (on the secondary market, they only invest in shares, do not provide any resource to the corporation, and only provide liquidity to the equity markets), etc.

26 On this, *see* Jean-Philippe Robé, *Property, Corporations, and Constitutionalization in a Global Political Economy*, European Law Open. https://doi.org/10.1017/elo.2023.3, on which this section heavily relies.

27 Nguyen Quoc Dinh, Patrick Dailler & Alain Pellet, *Droit international public*, Paris: Librairie Générale de Droit et de Jurisprudence (4° éd. 1992), p. 413.

28 John Gerard Ruggie, 'Taking Embedded Liberalism Global', in: *Taming Globalization: Frontiers of Governance*, pp. 93-129, David Held & Mathias Koenig-Archibugi (Eds.), Cambridge: Polity Press (2003), pp. 379-415.

29 Jean-Philippe Robé, *Property, Power and Politics – Why We Need to Rethink the World Power System*, Bristol: Bristol University Press (2020), Chapter 4.

30 Claire A. Cutler, *Transformation in Statehood, the Investor-State Regime and the New Constitutionalism*, 23(1) Indiana Journal of Global Legal Studies, pp. 95-125 (2016).

31 https://www.ohchr.org/sites/default/files/Documents/HRBodies/HRCouncil/WGTransCorp/Session6/LBI3rdDRAFT.pdf.

the Corporate Sustainability Reporting Directive (the "CSRD"), which came into effect on 5 January 2023. It is part of a wider European Green Deal, which commits the European Union to climate neutrality by 2050. The CSRD is part of the Sustainable Finance Package adopted by the European Commission on 21 April 2021 and will cover the public reporting elements of the due diligence duty of most companies that fall under the scope of the CSDDD. The CSRD extends the scope and reporting requirements of the existing Non-Financial Reporting Directive which mandates large public interest entities to report on their sustainability performance. According to the European Commission, this new legislation was required because "*reports often omit information that investors and other stakeholders think is important*". Reported information can be difficult to benchmark from company to company, and comparing performance is made extremely difficult. In the US context again, Michael Bloomberg considers that "*for the most part, the sustainability information that is disclosed by corporations today is not useful for investors and other decision-makers*".[32] Incidentally, one wonders how shareholders could "*drive the green transition*" with such information.

This is a worldwide issue and with the CSRD, the European Union attempts to ensure that businesses report reliable and comparable sustainability information to re-orient investments towards more sustainable companies.

One can regret a lack of ambition in the CSRD, however. Double materiality could prove to be a substantial step forward. But unchanged *financial* accounting rules make it possible to run the largest Ponzi scheme ever created: it is possible to distribute dividends made possible by the consumption of our natural capital which replacement cost is not accounted for. Doing so for financial capital is a criminal offence – a Ponzi scheme: a scheme in which *consumption of capital* [provided by new investors] is presented *as an income* [to earlier investors], as a creation of wealth. But doing the same thing with respect to natural capital is not even an accounting event. Traditional accounting is "corporate" accounting but not "firm" accounting. Accounts do not record the costs of maintaining assets that the accounting corporation does not own but on which it depends or the liabilities for which it is not legally or contractually obliged but for which it is responsible because of the impact of its activities over third parties.[33] "*As a result, … profit is overstated.*"[34] Ironically, a proper accounting of the use of natural capital, for example, would make it possible for financial markets to play their role in the proper allocation of resources to entities producing real value, and not mere "accounting shareholder value" made possible by an improper accounting of the negative environmental consequences of the activity.

The issue of identifying the firm boundaries for proper measurement of economic performance is equally present in the CSDDD. This is logically one of the points of contention between the Council and the Parliament. For example, the Political Compromise changed the scope of the due diligence obligations from a full life-cycle concept of "*value chain*" to a more limited "*chain of activities*" moving the limits of the firm closer to its core activities. The focus is put on a company's upstream and downstream supply chain, including distribution, but expressly excludes the use of products by consumers. The draft Wolters Report, on the contrary, goes beyond the Commission's draft by referring to the "*whole value chain approach*", extending the scope of the activities it deems under the control of the enterprise.

These definitional issues, as well as the information gathering exercise in connection with the newly created due diligence obligations could be a step towards an accounting of the replacement cost of the natural resources being used, in particular when it comes to climate change gas emissions where the use of effective accounting instruments will be increasingly urgent.[35]

8. Governance v. Government

The other available instrument is to address the way large global firms are being managed. These world private governments conduct their economic affairs worldwide in an integrated way, assessing strategic opportunities and risk management on an enterprise-wide basis. Their legal structure, however, is splintered into hundreds and sometimes thousands of corporations enabling assets partitioning all over the planet, and in numerous contracts connecting their operations to their value chains. No legally enforceable treaty exists today to reconnect the activities of these global firms to their impact. Only bits of their legal structure have legal personality and can be the subjects of (mostly local) legislation. But that is not true for the whole of the organisation. Gigantic private governments simply evade, as such, the legal system. This is where the CSDDD comes into play.

In the genealogy of the treatment of this issue, John G. Ruggie left us a legacy. He played an instrumental role in the elaboration of the voluntary United Nations instruments developed to start dealing with these issues and for him,

32 https://www.bloomberg.com/company/announcements/2015-bloomberg-impact-report-a-message-from-our-founder/.

33 Clara Barby, Richard Barker, Ronald Cohen, Robert G. Eccles, Christian Heller, Colin Mayer, Bruno Roche, George Serafeim, Judith C. Stroehle, Rupert Younger, & Thaddeus Zochowski, *Measuring Purpose: An Integrated Framework* (January 23, 2021). Available at SSRN: https://ssrn.com/abstract=3771892 or http://dx.doi.org/10.2139/ssrn.3771892.

34 *Id.*

35 *See generally* Richard Barker & Colin Mayer, *How Should a "Sustainable Corporation" Account for Natural Capital?* Saïd Business School Research Papers, RP-15 (2017). Jean-Philippe Robé, *The Shareholder Value Mess (and How to Clean It Up)*, Accounting, Economics, and Law: A Convivium | Volume 10: Issue 3, pp. 1-27 (2019).

> "conventional social science understandings of both constitutionalism and of the multinational enterprise are inadequate to fully grasp the ongoing transformation in global governance … traditional modes of global governance are inadequate to meeting pressing people and planet challenges."[36]

Ruggie held UN leadership positions in the two initiatives that explicitly recognised a transformation in global governance, including the increasing role played by multinational enterprises.[37] One of these initiatives is the UN Global Compact.[38] The other is the UN Guiding Principles on Business and Human Rights.[39] These efforts were the result of the recognition that all the attempts to subject multinational enterprises to an overarching international treaty instrument, starting in the 1970s, have all failed. Implementing a different methodology, the Global Compact was designed as a platform to engage business actors. It does this by providing a learning forum (identifying and sharing dilemmas and best practices); promoting public/private partnerships; and generating innovative spin-offs that then acquire lives of their own, such as the Principles for Responsible Investment.[40]

The UN Guiding Principles on Business and Human Rights build on, but go beyond, the Global Compact. In June 2011, the Human Rights Council unanimously endorsed a set of thirty-one GPs which are the first authoritative guidance the United Nations has issued for States and business enterprises on their respective obligations in relation to business and human rights.

As a result of these UN achievements, the OECD Guidelines for Multinational Enterprises were amended and now recapitulate the GPs' formulation of the corporate responsibility to respect human rights virtually *verbatim*. These principles are within the direct genealogy of the CSDDD. In the Political Compromise, the Council specifically provides that the due diligence process set out in the CSDDD 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.[41]

Beyond this UN strand in the genealogy of the CSDDD, there is another one which is widely acknowledged: the French vigilance duty and the provisions of the PACTE Statute as they relate to corporate governance. But whereas the UN and OECD rules are so-called "soft law" (unenforceable) rules, the two French instruments are mandatory.

9. The French Steering Process

Two major French Statutes paved the way for the CSDDD.

The first is a Statute of 27 March 2017[42] pursuant to which very large French enterprises have a "vigilance duty". They have an obligation to prevent social, environmental and governance risks related to their operations, wherever they are in the world. To do this, they must put in place a "vigilance plan" including risk assessment and prevention procedures in their relations with their subsidiaries, subcontractors, and suppliers.

The other relevant text is the so-called PACTE Statute which introduced a second paragraph to Article 1833 of the French Civil Code making it mandatory for each French company or partnership to be managed in its own interest "*taking into consideration the social and environmental issues linked to its activity*".[43]

The process which led to the adoption of this Statute is relevant. On 11 January 2018, a mission Letter was addressed by four French prominent ministers[44] to Ms.

36 John Gerard Ruggie, 'Foreword – Constitutionalization and the regulation of transnational firms', in: Jean-Philippe Robé, Antoine Lyon-Caen & Stéphane Vernac (Eds.), *Multinationals and the Constitutionalization of the World Power System*, pp. xii-xvii, Routledge (2016), p. xvii. *See also, generally*, Jean-Philippe Robé, *Property, Power and Politics – Why We Need to Rethink the World Power System*, Bristol: Bristol University Press (2020).

37 This heavily draws on Ruggie's own description of his role in Ruggie, *supra*.

38 https://www.unglobalcompact.org/.

39 https://www.ohchr.org/en/publications/reference-publications/guiding-principles-business-and-human-rights.

40 Which now involves "*more than 1,300 investment institutions with $ 45 trillion in assets under management, committed to including environmental, social and governance criteria in their investment decisions and to being active investors. In short, the Global Compact is a real-world example of what Robé calls 'micro-devices', intended to promote a more social conception of the firm within the business community itself*." In Ruggie, *supra*, p. xiv.

41 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.

42 Loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre.

43 The location of this duty in the Civil Code is far from being the most appropriate. As a consequence, this duty applies, for example, even to small family partnerships owning a studio apartment. The origin of this inappropriateness can be traced back to a report prepared for François Hollande in 2013 which proposed to rewrite Article 1833 altogether. The proposed text was: "*Any company must have a lawful object, be constituted and managed in the multiple interest of the stakeholders and contribute to the general interest, in particular economic, environmental and social*." Obviously, no corporate lawyer was involved in this suggestion which would probably have required changing the French constitution and amending the 1789 Declaration of Human Rights … Another rephrasing was later proposed by Emmanuel Macron when he was Finance Minister, in 2015. The latest amended draft of Article 1833 proposed at the time read: "*Any company must have a lawful purpose and be incorporated in the common interest of the shareholders. It must be managed to the best of its superior interests, while respecting the general economic, social, and environmental interest*." The proposal was fortunately withdrawn for a set of concurring reasons.

44 Bruno Le Maire, Minister of Economy and Finance, Nicolas Hulot, Minister of Ecological and Inclusive Transition, Muriel Pénicaud, Minister of Labor and Nicole Belloubet, Minister of Justice.

Nicole Notat and Mr. Jean-Dominique Senard.[45] It started with the statement that "*the French government wishes to launch a thinking process over the relationship between enterprises and the general interest*". It noted that society is expecting more from enterprises in connection with new environmental, social, and societal challenges. That,

> "however essential, the return on the shareholders' investment is not the sole raison d'être of enterprises [and] that answering to environmental challenges, ensuring the respect for human rights in a transnational production process and improving the employees' welfare are examples of legitimate ends that the enterprise must now address."

The Letter further requested an analysis of the pros and cons of amending the relevant provisions of the Civil and Commercial Codes. The purpose of the mission was to extend "*the field of what is possible*" and "*give enterprises a meaning going beyond short-term considerations to promote a vision of capitalism more in line with the general interest and the one of future generations*".

The report was to be finalised "*at the latest*" by 1 March 2018. The timeline was extremely short, and a small team worked around the clock to produce a synthesis which many hoped could be a game changer in French company law and beyond.[46] Some 200 interviews were conducted to gather as many viewpoints as possible from all corners of French society. The outcome is entitled "*L'entreprise, objet d'intérêt collectif*" (the so-called "Notat-Senard" Report).[47]

The drafting of the Report substantially benefited from the outcome of an earlier significant multi-disciplinary and multi-year research project which took place at the Collège des Bernardins in Paris on "*L'entreprise, formes de la propriété et responsabilité sociale*"[48] which started in 2009.[49] It attracted wide academic and media interest and proved to be in line with the political impetus to harness enterprises in the effort to address societal issues.[50]

Part of the work performed during the Bernardins research project was used to promote the adoption of the concept of "B Corp" under French law. It is now possible for a French company to voluntarily adopt a "*raison d'être*" and specify one or more social or environmental objectives the company sets to pursue within the conduct of its activity. The *société à mission* status is now available for those who want to show the world their altruistic intentions. Some are promoting its extension at the European level. For our purposes, however, the voluntary nature of this legal instrument is a major drawback. It turned out to be counterproductive in the process: opponents to a more significant reform quite successfully managed to direct the attention to this instrument, pointing out that those who want to "do good" now have an instrument to pursue their ends and that there was no need to upset others, more "business-minded". The problem, however, had never been to create a new corporate vehicle for those who want to do good.[51] The law has never prevented this. The issue was to find which appropriate *mandatory* legal rules preventing harm to the environment and humans at the world level could be invented. The issue was to address those enterprises which are damaging our natural environment and the inclusiveness of our societies and could not care less about the *société à mission* status.

Unquestionably, in their effort to mobilise enterprises as agents of positive change, both the Report and the Bernardins research project were very ambitious. But, as maintained in the Annex to the Political Compromise, "*a high level of protection and improvement of the quality of the environment and promoting European core values … require the involvement not only of the public authorities but also of private actors, in particular companies*". The ranks of those who consider that the classical public/private divide does not apply when we deal with global "private" business governments are increasing. In this regard, phrasing the problem to be addressed by the CSDDD as a shareholder v. stakeholder issue, or as a long-term v. short-term one[52] or as a mere CRS exercise misses the structural dimension of the problem. The world governance system is

45 Nicole Notat was from 1992 to 2002 General Secretary of the CFDT trade union and was then in charge of Vigeo Eiris, an international social and environmental rating agency founded in 2002. Jean-Dominique Senard was then the chairman of the Michelin Group.

46 I must disclose that with three other participants in the immediate working group (we ended-up being called the "gang of four"), I was extensively involved in the drafting of the Report. Another working group and report on *Le rôle sociétal de l'entreprise – Eléments de réflexion pour une réforme* (April 9, 2018) also played a role in the process leading to the PACTE Statute. Its drafting, however, was made extremely difficult due to extreme opposition by some participants on the drafting of consensus positions. *See* https://www.leclubdesjuristes.com/les-commissions/role-societal-de-lentreprise-elements-de-reflexion-reforme/.

47 See https://minefi.hosting.augure.com/Augure_Minefi/r/ContenuEnLigne/Download?id=FAA5CFBA-6EF5-4FDF-82D8-B46443BDB61B&filename=-entreprise_objet_interet_collectif.pdf. For a good summary of these new provisions and the context of their approval, *see* Clémentine Bourgeois, Xavier Hollandts & Bertrand Valiorgue, *La loi PACTE: enjeux et perspectives pour la gouvernance des sociétés françaises*, Revue française de gouvernance d'entreprise, pp. 4-29 (2021).

48 https://www.collegedesbernardins.fr/recherche/lentreprise-formes-de-la-propriete-et-responsabilites-sociales-20092011.

49 The originator of the project is Olivier Favereau, a renowned French economist, who invited Guillemette de Larquier, Armand Hatchuel and me to join in the submission of the project which, once retained, gathered tens of researchers from virtually all the social sciences.

50 On October 15, 2017, Emmanuel Macron stated (in an interview on TF1 TV channel) that "*the firm cannot be just a gathering of shareholders*".

51 4 years after the adoption of the PACTE Statute, only 990 of all the French companies are *sociétés à mission*. This is about 43 per 100,000 French companies (0.00043%).

52 As did the damaging and easily criticisable E&Y "*Study on directors' duties and sustainable corporate governance*" prepared for the Commission and published in July 2020. https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en.

going through a major mutation, as John R. Ruggie witnessed, and we just can't keep on using schemes of analysis that do not match reality. Obviously, the existing World Power System is constituted of States and institutions derived from them – but a key to the understanding of this Power System is that in its constitution, in both a dynamic and static sense, one also finds firms: global, multinational firms.[53] They have played an instrumental role in the coming about of this new Power System, and they must be understood as forming part of it. They are holders of power to be made accountable for its use, not just bystanders abiding by the rules made by others. They are certainly not public, but they are not purely private.

Although the evidence is still scarce, one can witness that courts are playing their role in steering the accountability process and the French precedents provide ammunition for this.

10. **Steering Courts**

Armed with the new tools introduced under French law, localities and NGOs challenged in court one of the world's largest private governments: Total.

Total SE, the French holding company of the Total group (1,191 companies active in 130 countries), published its vigilance plan on 15 March 2018. A disparate set of French municipalities and regions and private law associations considered the plan presented as being insufficient and decided to take legal action against Total SE to improve it. Total SE challenged the jurisdiction of the court. By an Order issued on 11 February 2021, the Nanterre Court declared itself competent to review the challenge.[54]

What is relevant for us here is the judge's reasoning on the meaning of the new provisions adopted under French law and what they concretely impose on large companies. The Court combined in its reasoning the vigilance duty with the amendment made to Article 1833 by the PACTE Statute. Since that date, any French company must "*be managed in its corporate interest, taking into consideration the social and environmental impacts of its activity*". Some wondered whether these provisions could have any real-life impact. According to the Nanterre judge, given the combined effect of these two texts,

> "… the strategic choices of Total SE … can no longer be made in a strict economic logic but by integrating elements previously conceived as exogenous: now managed, pursuant to article 1833 of the Civil Code, "*in its social interest, taking into consideration the social and environmental impacts of its activity*" …, it must integrate into its strategic orientations the risks of infringements of human rights and the environment and, in fact, with regard to the nature of its activity, proceed to dropouts or substantial reorientations."

Based on this reasoning, the Judgment further states that:

> "… the vigilance plan of such a company directly affects Society as a whole, an impact that constitutes its raison d'être, and falls within the social responsibility of Total SE, … the preservation of human rights and Nature in general cannot be content with "risk management" … but commands judicial review. And this requires a strong social control allowed by the publicity of the vigilance plan and a wide definition of the interest to act, standing being … granted to any person justifying an interest to act."

With the combined effect of the vigilance duty and the promotion of social and environmental concerns in the Civil Code, Total's world government must now integrate in its decision-making processes the preservation of human rights and of the natural environment, "*elements* [which were] *previously conceived as exogenous*". What was "*exogenous*" in compliance with the tenets of "agency theory" must now be integrated into corporate decisions. Alongside efficiency considerations, the preservation of fundamental rights and of nature is now *endogenous* to corporate governance.

It is interesting to put this case in parallel with a recent one involving Shell. A Dutch court treated this global enterprise as a world private government with a duty to act against climate change.[55] The specific issue at stake was to determine whether Royal Dutch Shell PLC ("RDS") has the obligation to reduce CO_2 emissions of the Shell group's entire energy portfolio through the corporate policy of the Shell group. The Hague District Court ordered RDS to reduce the CO_2 emissions of the Shell Group's activities by

53 In earlier and parallel works, I applied the concept of "constitutionalization" to large business firms. *See* Jean-Philippe Robé, *Les entreprises multinationales, vecteurs d'un nouveau constitutionnalisme*, 56 Archives de Philosophie du Droit 337-361 (2013), 'Globalization and constitutionalization of the world-power system', in: Jean-Philippe Robé, Antoine Lyon-Caen & Stéphane Vernac (Eds.), *Multinationals and the Constitutionalization of the World Power System*, with a Foreword from John Gerard Ruggie, Routledge (2016), 'La place de l'entreprise dans le système de pouvoirs', in: Pierre Musso (Ed.), *L'entreprise contre l'État*, pp. 152-160, Editions Manucius (2017); *Eigentum verteilt Macht*, Zeit Online, November 3 (2021); *Théorie de l'entreprise, droit des sociétés et gouvernance d'entreprise soutenable*, XXXV(2) Revue Internationale de Droit Economique, pp. 179-191 (2021); *Taming Property*, 4(3) Revue Européenne du Droit pp. 167-169 (2022).

54 https://www.actu-environnement.com/media/pdf/news-37043-ordonnance-tribunal-nanterre-total-devoir-vigilance.pdf. *See also* Jean-Philippe Robé, *Une forme de droit nouveau est peut-être en train de se créer sous nos yeux*, Le Monde, 19 mars (2021).

55 *Vereniging Milieudefensie et al. v. Royal Dutch Shell PLC*, The Hague District Court, Judgment of May 26, 2021 (hereafter, *Milieudefensie et al. v. Shell*). An English version of the decision is available at: ECLI:NL:RBDHA:2021:5339, Rb. Den Haag, C/09/571932 / HA ZA 19-379 (Engelse versie). For a more detailed presentation of my interpretation of the case, *see* Jean-Philippe Robé, *Property, corporations and Constitutionalization in a Global Political Economy*, European Law Open. https://doi.org/10.1017/elo.2023.3.

45% at the end of 2030 relative to 2019 through the Shell group's corporate policy.

The Judgement indicates that "*RDS is a public limited company, a legal person under private law, established under the laws of England and Wales. Its head office is established in The Hague.*" But via this specific *private law* corporation, it is a much larger *organisation* which is impacted by the Decision. The Court notes that RDS is the top holding of the Shell Group. The Shell group is composed of 1,100 companies operating in 160 countries on which RDS has "*a policy-setting influence*" due, of course, to its direct or indirect ownership of the shares issued by these corporations. Consequently, under the Decision, RDS has an *obligation of result* with regards to the CO_2 emissions of *these* separate entities; but with regards to sub-contractors and consumers, RDS has a *significant best-efforts obligation*.

In its defence, RDS position was that the energy transition requires a concerted effort of society as a whole and that the solution should not be provided by a court, but by "*the legislator and politics*". Via a very detailed and carefully worded decision, the Court decided on the case, considering that it was not going "*beyond the law-making function of the court*". For the Court, although the legal instruments of international law are not binding on enterprises, the duty to respect human rights is a global standard of expected conduct *for all business enterprises wherever they operate*. The serious and irreversible consequences of dangerous climate change pose a threat to the human right to live. For the Court, tackling dangerous climate change needs immediate action and this is not an optional responsibility; it applies everywhere and is not passive. It is undisputed that RDS is not the only party responsible for tackling dangerous climate change, but this does not absolve RDS from its individual partial responsibility.

The managerial setup of RDS as a global firm is subjected to higher non-negotiable human rights ("*There is no room for weighting interests*", the Court wrote), taking on the character of constitutional principles.[56] The Court did so, and could only do so, towards the issue at stake in the specific case at hand: the preservation of a liveable planet, which is a limit to court induced adaptations of the law. But as a large world government in connection with the operations it controls, Shell is declared to be under a duty to respect human rights. All its operations are now subject to this imperative and the human right to life must be respected no matter what. Dangerous climate change is a threat to human rights and no excuse, pecuniary or otherwise, can reduce the obligation to respect this human right.

Without upsetting the complex legal structuring of the "private" part of the World Power System, these decisions impose upon private world governments superior norms to force them to be compatible with the survival of our species and its environment. These are superb law-making court decisions. But they now need to be relayed by *legislative instruments* extending these efforts beyond RDS and Total. This is what the CSDDD can and indeed must achieve. In its defence, RDS argued that "*states determine the playing field and the rules for private parties*" and that "*the energy transition must be achieved by society as a whole, not by just one private party*". RDS complained that "*imposing a reduction obligation on* [RDS] *will lead to unfair competition and a disruption of the level playing field on the oil and gas market*".

A properly drafted CSDDD will address this concern and put global competitors on a par.

11. **Conclusion**

Coming from various corners, many forces in the natural and social sciences and in the legal world are trying to steer a complex process towards the development of legal institutions making worldwide human economic activity more compliant with the needs of the natural environment and the humans living in it. A key institution which needs to be better understood for lawmakers worldwide to limit its dangers and harness its strengths is the multinational enterprise. As we have seen, important court cases are courageously addressing this power issue by making it mandatory to integrate interests previously considered exogenous within the decision-making processes of some of the largest firms. The draft CSDDD builds on this scholarship and these court precedents. But it is important for the present debate not to go sideways. The faith in market fundamentalism or excessive ambitions incompatible with the conduct of even the most responsible businesses are equally dangerous obstacles. A CSDDD putting the limits of firms where their directing power effectively ends, with a clear mandate to address issues differently depending on the risks involved, would provide the realistic level playing field firms are legitimately expecting. The delicate balance to find is to be extremely ambitious within the limits of what private world governments can effectively deliver.

56 Poul F. Kjaer, *Constitutionalizing Connectivity: The Constitutional Grid of World Society*, 45(1) Journal of Law and Society, pp. 114-134 (2018), p. 133.

Samuel Garcia Nelen[1]

The Proposal for a Corporate Sustainability Due Diligence Directive: Background and Latest Developments

Ondernemingsrecht 2023/32

- **Create a level playing field within the EU by setting minimum governance standards that require companies to promote long-term, sustainable value creation and to take into account environmental and human rights impacts in their value chain, without linking this to director liability.**
- **Provide more clarity around stakeholder engagement, by facilitating effective consultations with stakeholders that are potentially impacted by certain company decisions. Companies could be required to take the outcome of stakeholder consultations into account in their decision-making, but in the end, they should always have a choice to set aside this outcome in the interest of long-term, sustainable value creation.**

The EU proposal for a Directive on Corporate Sustainability Due Diligence lays down rules on obligations for companies regarding actual and potential human rights and environmentally adverse impacts with respect to their own operations, those of their subsidiaries, and the value chain operations carried out by their established business relationships, as well as rules on liability for violations of these obligations. In this article, the author explains the background of the CSDDD, highlights some observations regarding the initial proposal of the European Commission and the main changes as envisaged in the Political Compromise text of the Council, and touches on the interaction between the CSDDD and other EU initiatives in the field of corporate sustainability, the interaction with other Dutch corporate law developments, and the expected next steps in the legislative process.

1. Introduction

The EU proposal for a Directive on Corporate Sustainability Due Diligence (hereafter, the CSDDD) lays down rules on obligations for companies regarding actual and potential human rights and environmentally adverse impacts with respect to their own operations, those of their subsidiaries, and the value chain operations carried out by their established business relationships, as well as rules on liability for violations of these obligations. The CSDDD is a result of the European Commission's initiative on sustainable corporate governance.[2]

The original proposal for a CSDDD was submitted by the European Commission to the European Parliament and the European Council on 23 February 2022 (hereafter, the Commission Proposal).[3] After a period of review and negotiations, the Council reached political agreement on a revised text for the CSDDD by agreeing on a 'general approach' on 1 December 2022.[4] Based on this general approach, the Council will begin negotiations with the European Parliament. The general approach consists of a significantly revised proposal for a CSDDD (hereafter, the Political Compromise).[5]

This article explains the background of the CSDDD, highlights some observations regarding the Commission Proposal and the main changes as envisaged in the Political Compromise, and touches on the interaction between the CSDDD and other EU initiatives in the field of corporate sustainability, the interaction with other Dutch corporate law developments, and the expected next steps in the legislative process. For more detail on the content of the provisions of the CSDDD, I refer to the other contributions in this journal.

1 Samuel Garcia Nelen is a lawyer at Allen & Overy LLP in Amsterdam, assistant professor at the Erasmus School of Law in Rotterdam and a permanent contributor to this journal. Any views or opinions expressed in this article are personal and belong solely to the author and do not represent those of institutions or organisations that the author may be associated with. Certain parts of this article are translated from earlier articles on the EU initiative on sustainable corporate governance and the original proposal for a Directive on Corporate Sustainability Due Diligence as published in this journal, see S.B. Garcia Nelen, 'Een Europees initiatief voor duurzame corporate governance', *Ondernemingsrecht* 2021/32 and S.B. Garcia Nelen, 'Het voorstel voor een Europese Corporate Sustainability Due Diligence-richtlijn', *Ondernemingsrecht* 2022/41.

2 S.B. Garcia Nelen, 'Een Europees initiatief voor duurzame corporate governance', *Ondernemingsrecht* 2021/32.

3 Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, 23 February 2022, COM(2022) 71 final.

4 https://www.consilium.europa.eu/en/press/press-releases/2022/12/01/council-adopts-position-on-due-diligence-rules-for-large-companies/.

5 Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 – General Approach, 30 November 2022.

2. Background of the CSDDD: the European Green Deal and the EU Initiative on Sustainable Corporate Governance

In December 2019, the Commission published its plans for a European Green Deal.[6] The objective of achieving "climate neutrality" within the EU by 2050 is a part of these plans, a goal that had already been set in 2018.[7] To achieve this objective, greenhouse gas emissions are to be reduced by at least 55% compared to 1990 levels by 2030.[8] According to the Commission, the behaviour of companies across all sectors of the economy is the key to success in achieving these objectives and in delivering on the United Nations Sustainable Development Goals.[9] The European Green Deal notes that sustainability should be further embedded into the corporate governance framework. The Commission has repeatedly indicated that it would be supporting this through a new policy initiative, for instance in the COVID-19 recovery plan (*NextGenerationEU*),[10] the *Circular Economy Action Plan*,[11] the *Biodiversity Strategy*,[12] and the *Farm to Fork Strategy*.[13] In a resolution of 17 December 2020, the European Parliament called on the Commission to translate these intentions into new legislation.[14] The European Parliament adopted another resolution in March 2021 with recommendations to the Commission in the field of corporate governance, including a specific proposal for a directive on corporate due diligence and corporate accountability.[15]

Meanwhile, on 30 July 2020, the Commission published an *inception impact assessment* on this topic, which it had labelled the 'EU initiative on sustainable corporate governance'.[16] According to the inception impact assessment, the first proposal in this initiative would be to clarify that directors, as part of their duty to act in the corporate interest, should take into account the interests of all stakeholders relevant to the long-term sustainability of the company or those affected by it (including employees, environment, and other stakeholders affected by the business). The second proposal was to introduce a due diligence duty, which would require companies to take measures to address their adverse sustainability impacts, such as climate change, environmental and human rights harm in their own operations and in their value chain by identifying and preventing relevant risks and mitigating negative impacts.

The key assumption underlying the first policy proposal on directors' duties was that, according to the Commission, undue short-term market pressures make it difficult to lengthen the time horizon in corporate decision-making. As a result, corporate managers could become overly focused on short-term financial performance and disregard opportunities and risks stemming from environmental and social sustainability considerations.[17] On behalf of the Commission, EY investigated the alleged short-term pressure. The findings of that study are included in the report '*Study on directors' duties and sustainable corporate governance*'.[18] In brief, the report concludes that there is a trend, for publicly listed companies within the EU, of focusing on short-term benefits of shareholders rather than on the long-term interests of the company. According to the report, this is partly due to the fact that directors' duties and the company's interest are interpreted narrowly and tend to favour the short-term maximisation of shareholder value, combined with increasing pressure from investors and the lack of a strategic perspective on sustainability.[19] The EY report has been strongly criticised.[20] The second policy proposal, the introduction of a due diligence obligation, is partly based on the report '*Study on due diligence requirements through the supply chain*'.[21] This report showed that only a limited number of companies that participated in the research were undertaking due diligence which takes into account all human rights and environmental impacts covering the entire value chain.[22] In addition, it showed that there is broad support among the respondents for a mandatory due diligence obligation, including among

6 '*Communication from the Commission – The European Green Deal*', 11 December 2019, COM(2019) 640.

7 '*A Clean Planet for all – A European strategic long-term vision for a prosperous, modern, competitive and climate neutral economy*', 28 November 2018, COM(2018) 773.

8 Articles 2(1) and 4(1) of 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 (hereafter, the European Climate Law).

9 Explanatory memorandum to the proposal for a Directive (hereafter, the Explanatory Memorandum), page 1, and recital 2 of the Commission Proposal. See also United Nations Resolution 70/1 (2015) adopted by the General Assembly on 25 September 2015.

10 '*Europe's moment: Repair and Prepare for the Next Generation*', 27 May 2020, COM(2020) 456.

11 '*A new Circular Economy Action Plan For a cleaner and more competitive Europe*', 11 March 2020, COM/2020/98 final.

12 '*EU Biodiversity Strategy for 2030*', 20 May 2020, COM(2020) 380 final.

13 '*A Farm to Fork Strategy for a fair, healthy and environmentally-friendly food system*', 20 May 2020, COM/2020/381 final.

14 European Parliament resolution of 17 December 2020 on sustainable corporate governance (2020/2137(INI)).

15 European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)).

16 '*Inception impact assessment – Sustainable corporate governance*', 30 July 2020, ec.europa.eu.

17 '*Action Plan: Financing Sustainable Growth Brussels*', 8 March 2018, COM(2018) 97 final.

18 '*Study on directors' duties and sustainable corporate governance*', July 2020, op.europa.eu.

19 '*Study on directors' duties and sustainable corporate governance*', July 2020, op.europa.eu, page 40.

20 Including by J.M. Fried & C.C.Y. Wang, 'Short-Termism, Shareholder Payouts, and Investment in the EU', *ECGI Law Working Paper*, no. 544/2020, October 2020; M.J. Roe et al., 'The European Commission's Sustainable Corporate Governance Report: A Critique', *ECGI Law Working Paper*, no. 553/2020, November 2020 and the European Law Experts Group, 'A Critique of the Study on Directors' Duties and Sustainable Corporate Governance Prepared by Ernst & Young for the European Commission', *Oxford Business Law Blog*, 9 December 2020.

21 '*Study on due diligence requirements through the supply chain*', January 2020, op.europa.eu.

22 '*Study on due diligence requirements through the supply chain*', January 2020, op.europa.eu, pages 48-50.

businesses, as such an obligation could promote a level playing field and increase legal certainty.[23]

3. The Commission Proposal

At the time of publication of the inception impact assessment, the Commission expected that the legislative initiative might result in a proposal for a directive as early as the second quarter of 2021.[24] However, the impact assessment report was met with a negative opinion from the Regulatory Scrutiny Board.[25] A revised assessment report was submitted to the Regulatory Scrutiny Board, which again received a negative opinion.[26] The Regulatory Scrutiny Board 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.[27] The legislative proposal was then amended to address the concerns of the Regulatory Scrutiny Board. Whether these concerns have indeed been appropriately addressed will remain unknown, as the Commission decided to continue with the initiative despite the negative opinions. The Commission considered it important to adopt a proposal for a directive because of the political importance of this initiative for the Commission's priorities, the urgency for action in the field of value chain due diligence, and because the additional clarifications and adjustments to the proposal, in the Commission's view, sufficiently addressed the shortcomings of the impact assessments.[28]

As a result of the criticism of the Regulatory Scrutiny Board, and possibly other stakeholders, the scope of the Commission Proposal was ultimately considerably limited compared to the initial proposals included in the impact assessment. In particular, the proposal no longer introduced a broad obligation requiring that, as part of their duty to act in the corporate interest, directors and supervisory directors must take into account the interests of all stakeholders relevant to the company.[29] Instead, the provisions on the directors' duties in the Commission Proposal were significantly limited and explicitly linked to the due diligence obligation.

The larger part of the Commission Proposal consists of provisions that aim to introduce a mandatory due diligence obligation. In short, this means that companies that fall within the scope of the proposed CSDDD will be obliged to identify actual or potential negative consequences for their business operations in terms of human rights and the environment and to prevent and limit them where possible. The Commission Proposal has a broad scope, as it covers companies that exceed certain thresholds and that are established or active within the EU, regardless of whether or not they are listed on the stock exchange. The outcome of the consultation activities showed that an EU legal framework for such an obligation was desirable, in particular for large companies, in order to improve legal certainty and create a level playing field.[30]

The due diligence requirements in the Commission Proposal are largely based on the concept of human rights due diligence, which was specified and further developed in the OECD Guidelines for Multinational Enterprises, extending the application of due diligence to environmental and governance topics.[31] The OECD Guidance on Responsible Business Conduct and sectoral guidance are internationally recognised frameworks setting out practical due diligence steps to identify, prevent, mitigate and account for how companies address actual and potential impacts in their operations and value chains.[32]

4. The Political Compromise as proposed by the Council

The Political Compromise is the result of review and negotiations within the Council that took place between 24 February 2022 and 1 December 2022. This process led to the Political Compromise, which contains various proposed changes compared to the Commission Proposal. I will highlight a few of the key changes below.

In the Political Compromise, the term 'value chain' has been replaced by 'chain of activities'. As to the scope of the chain of activities covered under the definition, the compromise text moved from the concept of a full 'value chain' towards the 'supply chain' concept by leaving out the phase of the use of the company's products or provision of services.[33] The activities of a company's downstream part of the supply chain now only extend to business partners

23 Although not among industry organisations, see '*Study on due diligence requirements through the supply chain*', January 2020, op.europa.eu, page 97.
24 '*Inception impact assessment – Sustainable corporate governance*', 30 July 2020, ec.europa.eu.
25 The Regulatory Scrutiny Board is an advisory body that supports the Commission in monitoring the quality of proposed legislation.
26 Explanatory Memorandum, page 20.
27 Explanatory Memorandum, page 20.
28 Explanatory Memorandum, pages 20-21.
29 Explanatory Memorandum, page 21 and *Commission Staff Working Document, Follow-up to the second opinion of the Regulatory Scrutiny Board*, 23 February 2022, page 8.
30 Explanatory Memorandum, page 18.
31 OECD Guidelines for Multinational Enterprises, 2011 edition, available at http://mneguidelines.oecd.org/guidelines/.
32 Recital 6 of the Commission Proposal. See in this same journal: A.J.F. Lafarre, 'Mandatory Corporate Sustainability Due Diligence in Global Value Chains: The Long-Awaited European Solution Compared to Existing International Standards', *Ondernemingsrecht* 2023/33.
33 Political Compromise, pages 6-7.

where they carry out those activities for or on behalf of the company, but not the disposal of the product by consumers.[34] When this is applied to greenhouse gas emissions, the scope of activities is more limited than what is typically referred to as 'scope 3', which includes all 'indirect' emissions resulting from the activities of a company occurring from greenhouse gas sources owned or controlled by third parties, such as business partners or consumers.[35] In the Netherlands, a court held Royal Dutch Shell responsible for the reduction of such scope 3 emissions.[36] The Dutch government recently indicated that it is in favour of including scope 3 emissions under the scope of the CSDDD and that it has resisted the currently envisaged limitation of the CSDDD to the 'downstream' part of the chain of activities.[37]

When transposing the CSDDD, member states can make their own decision on whether or not to include the provisions of financial services by regulated financial undertakings.[38] If they do, both the type of activities and the parties that are included in the chain are limited. As to the type of activities, the definition of 'chain of activities' only includes services that directly result in an allocation of capital or in the coverage of risk through insurance or reinsurance. As to the parties included in the chain, these would be limited to the recipients of the activities and their subsidiaries benefiting from the service whose activities are linked to the service in question. The chain would not include business partners or recipients that are households or natural persons not acting in a professional or business capacity, or small- and medium-sized enterprises.[39] In addition, the Political Compromise does not require financial undertakings to temporarily suspend or terminate a business relationship.[40] For other types of companies, there are other exceptions under which no temporary suspension or termination is required.[41]

The Commission Proposal required Member States to ensure that companies, when setting variable remuneration, take into account the fulfilment of the obligations to draw up a climate transition plan, including, where relevant, emission reduction objectives, if variable remuneration is linked to the contribution of a director to the company's business strategy and long-term interests and sustainability. This provision has been deleted in the Political Compromise due to the strong concerns of Member States regarding the proposed link between the variable remuneration of directors and their contribution to the company's business strategy and long-term interest and sustainability.[42] According to the Political Compromise, the form and structure of directors' remuneration are matters primarily falling within the competence of the company and its relevant bodies or shareholders. Member states called for non-interference with different corporate governance systems within the EU, which reflects different views about the roles of companies and their bodies in determining the remuneration of directors.

In the Political Compromise, the provision on civil liability for companies under the proposed Article 22 of the CSDDD has been amended to clarify and limit potential liability for companies.[43] Companies may only become liable if and when that company intentionally or negligently failed to prevent and mitigate potential adverse impacts or to bring actual impacts to an end and minimise their extent and as a result of such a failure damage was caused to a natural or legal person.[44] In contrast to the Commission Proposal, where a company could avoid liability in its value chain caused by indirect partners by seeking contractual assurances from its direct partners, under the Political Compromise a company cannot be held liable at all if the damage was caused only by its direct or indirect business partners in its chain of activities.[45] In addition, when identifying actual and potential adverse impacts, companies are allowed to apply a risk-based approach and the adverse impacts, once identified, may be addressed in order of priority.[46] The Dutch government has argued for the inclusion of the option of using this risk-based approach and against reliance on contractual assurances in the chain of activities in the context of the CSDDD's liability framework for companies.[47]

One of the key changes in the Political Compromise is the deletion of two articles that regulated the directors' duties for companies incorporated in a Member State. The first provided for a duty of care and associated liability and the second laid down the duty for directors to set up and oversee the due diligence actions and to adapt the corporate strategy to take into account the identified adverse impacts and adopted due diligence measures.[48] The deletion of the provision regulating the liability relating to the directors' duty of care was supported by the Dutch government.[49] The Political Compromise indicates that the 'main

34 Recital 18 of the Political Compromise.
35 The Hague District Court 26 May 2021, ECLI:NL:RBDHA:2021:5339 (*Milieudefensie et al. v. Royal Dutch Shell plc*), par. 2.5.4.
36 The Hague District Court 26 May 2021, ECLI:NL:RBDHA:2021:5339 (*Milieudefensie et al. v. Royal Dutch Shell plc*).
37 *Kamerstukken I* 2022/23, 36 146, A, page 7 and *Kamerstukken I* 2022/23, 36 146, B, page 3.
38 Article 2(8) and pages 7-8 of the Political Compromise. See in this same journal: L.J.M. Baks et al., 'Practical Implications of the CSDDD: a Threat to its Effectiveness', *Ondernemingsrecht* 2023/39.
39 Article 3(g) and recital 19 of the Political Compromise.
40 Article 7(6), Article 8(7) and recital 36b of the Political Compromise.
41 Article 7(7), Article 8(8) and recital 41a of the Political Compromise.
42 Political Compromise, page 9.
43 Political Compromise, pages 9-10.
44 Article 22(1) and recital 56 of the Political Compromise. See in this same journal: L. Lennarts, 'Civil Liability of Companies for Failure to Conduct Corporate Sustainability Due Diligence Throughout Their Value Chains – Is Art. 22 CSDDD Fit for Purpose?', *Ondernemingsrecht* 2023/36.
45 Article 22(2) of the Political Compromise.
46 Articles 6(1a) and 6a of the Political Compromise.
47 *Kamerstukken I* 2022/23, 36 146, B, page 2.
48 Articles 25 and 26 of the Commission Proposal.
49 *Kamerstukken I* 2022/23, 36 146, B, page 2.

elements' of the second provision have been moved to Article 5(3), but the latter article does not add much compared to the already existing obligations, in particular, Article 4(1), in contrast to Article 26 of the Commission Proposal. Indeed, some of the 'main elements' of Article 26 of the Commission Proposal appear to be deleted altogether.

Generally, it appears that the proposed changes in the Political Compromise aim to provide clarity and predictability, but in some instances, they also limit interference in the corporate governance rules of individual Member States. Historically, corporate governance has mainly been the domain of national traditions, with clear differences between Member States.[50] There is currently no EU-wide legislation that provides for unifying rules on corporate governance in the strict sense (i.e. the governance structure and the division of powers and responsibilities between the corporate bodies).[51] Although clarity and predictability for companies are important factors for an attractive business environment, the continuation of differences in corporate governance rules within the EU does not contribute to a true level playing field. Although multiple recitals of the Political Compromise still refer to the original intention of the EU institutions to amend corporate governance rules, the provisions of the Political Compromise no longer provide for such changes.[52]

5. Interaction with other EU Initiatives in the Field of Corporate Sustainability

In its efforts to make businesses operate in a more sustainable manner, the EU has so far mainly introduced reporting obligations.[53] These obligations predominantly follow from the Non-Financial Reporting Directive (the NFRD),[54] implemented in the Netherlands by the Decree on disclosure of non-financial information (*Besluit bekendmaking niet-financiële informatie*).[55] The NFRD concerned an amendment to the Accounting Directive and introduced obligations with regard to the reporting of so-called non-financial information. According to the Commission, these reporting obligations have not led to sufficient improvements.[56] On 21 April 2021, the Commission adopted a proposal for a Corporate Sustainability Reporting Directive (the CSRD),[57] which aims to significantly expand the scope of and obligations under the NFRD. The CSRD was finally adopted on 28 November 2022 and entered into force on 5 January 2023.[58] Member States will have 18 months to implement the CSRD in national legislation. The first obligations will start to apply to certain companies when reporting on the financial year 2024.

Other relevant European regulations for corporate sustainability reporting are the Sustainable Finance Disclosure Regulation (the SFDR)[59] and the Taxonomy Regulation.[60] The SFDR entered into force on 10 March 2021 and applies to financial market participants (such as certain insurance and investment firms and credit institutions) and financial advisers. Under the SFDR, when financial market participants have more than 500 employees, they are required to publish on their website a statement about their due diligence policy regarding the main negative effects of investment decisions on sustainability factors.[61] The Taxonomy Regulation entered into force on 12 July 2020 and applies, among other things, to companies that are subject to the NFRD (as amended by the CSRD). This regulation prescribes how to determine which economic activities qualify as 'environmentally sustainable'. This is intended to prevent *greenwashing* and provide investors with more clarity about which investments can be considered 'green'.[62] Environmentally sustainable activities must also comply with minimum safeguards of social rights.[63] This means that a company must have procedures in place to ensure compliance with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.[64]

50 M.A. Verbrugh, 'Naar een beter ondernemingsrecht', *Ondernemingsrecht* 2020/20, par. 3.4.
51 S.B. Garcia Nelen, *De beursvennootschap, corporate governance en strategie (Instituut voor Ondernemingsrecht nr. 120)* (diss. Rotterdam), Deventer: Wolters Kluwer 2020, par. 7.4.1.
52 Political Compromise, recitals 9, 11 and 13.
53 I only refer to the generally applicable rules and not to industry-specific legislation, such as Directive 2011/36/EU of 5 April 2011 on preventing and combating trafficking in human beings and protecting its victims and the Conflict Minerals Regulation. For a comprehensive list of relevant European legislation, see pages 3-8 of the Explanatory Memorandum.
54 Directive 2014/95/EU of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.
55 Decision of 14 March 2017 laying down rules for the implementation of Directive 2014/95/EU of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (*Besluit van 14 maart 2017, houdende regels ter uitvoering van richtlijn 2014/95/EU van het Europees Parlement en van de Raad van 22 oktober 2014 tot wijziging van richtlijn 2013/34/EU met betrekking tot de bekendmaking van niet-financiële informatie en informatie inzake diversiteit door bepaalde grote ondernemingen en groepen*).
56 Explanatory Memorandum, page 4.
57 Directive (EU) 2022/2464 of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.
58 *Official Journal of the EU*, L 322, 16 December 2022.
59 Regulation (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial services sector.
60 Regulation (EU) 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.
61 Article 4(3) of the SFDR. On the basis of the first paragraph of that article, financial market participants with fewer than 500 employees are only obliged to publish such a statement *where they consider principal adverse impacts of investment decisions on sustainability factors*. Where they do not consider adverse impacts of investment decisions on sustainability factors, they should publish clear reasons as to why they do not do so, including, where relevant, information as to whether and when they intend to consider such adverse impacts ('apply or explain').
62 The term *greenwashing* refers to obtaining an unfair competitive advantage by marketing a financial product as environmentally friendly, when in fact basic environmental standards have not been met. See recital (11) of the Taxonomy Regulation.
63 Article 3(c) of the Taxonomy Regulation.
64 Article 18(1) of the Taxonomy Regulation.

The common denominator between the existing and intended European sustainability rules mentioned above is that they impose reporting obligations on companies. The proposal for a CSDDD is seen as complementary to these reporting rules, as it adds substantive obligations to the reporting obligations. By requiring companies to implement processes for due diligence, ultimately the reporting (which itself is the last step of the due diligence process) should become more reliable and useful.[65]

6. Interaction with Developments in the Netherlands relevant to Corporate Sustainability

In the Netherlands, two developments are of particular relevance. The first one is the proposed Bill on Responsible and Sustainable International Entrepreneurship (*Wet verantwoord en duurzaam internationaal ondernemen*).[66] This legislative proposal by four members of the Dutch parliament would oblige companies to, among other things, apply due diligence in the field of human rights, labour rights and the environment. In essence, this proposal is very similar to the CSDDD.[67] In a similar way, the proposal seeks to introduce mandatory due diligence requirements that align with the OECD Due Diligence Guidance for Responsible Business Conduct. The Dutch government has indicated that the CSDDD will serve as the basis for the national bill. The aim is to have the legislative processes of both proposals run in parallel as much as possible, which means that changes provided for in the draft CSDDD can be included in the national legislative process. The initiators of the national bill believe that initiating a process towards national legislation will increase the chance of an ambitious European proposal, as the more Member States develop their own initiatives, the greater the pressure will be on the entire EU to adopt legislation at the European level.[68]

The second development is the updated Dutch Corporate Governance Code that was published on 20 December 2022.[69] The updates include requirements for directors to focus on sustainable long-term value creation when determining strategy and making decisions and to take the interests of stakeholders into account.[70] In addition, companies must establish a policy for diversity and inclusion for the entire business.[71] The updated Corporate Governance Code also requires companies to take into account the impact of the company and its affiliated enterprise in the field of sustainability, including the effects on people and the environment, and to paying a fair share of tax to the countries in which the company operates.[72] To ensure that the interests of the relevant stakeholders of the company are considered when the sustainability aspects of the strategy are determined, the company should draw up a policy for effective dialogue with those stakeholders.[73] The CSDDD is mentioned in the Corporate Governance Code as it, like other legislation and international instruments, can serve as a guide to the interpretation of the concept of sustainability.[74]

7. Expected next Steps in the Legislative Process for the CSDDD

The next step in the CSDDD's legislative process is for the European Parliament to agree on a position in respect of the Commission Proposal. This process is not progressing as quickly as some may have hoped. Just before the publication of the Political Compromise, on 7 November 2022, the rapporteur of the European Parliament, Dutch member Lara Wolters, published her draft report on the Commission Proposal.[75] The proposals in the draft report are quite different from the changes proposed in the Political Compromise. The draft report contained significant and detailed proposals for amendments to the Committee Proposal, generally showing strong support for extensive due diligence obligations, expanding the scope of the Commission Proposal, further detailing the directors' duties and including additional requirements to link a significant portion of the variable remuneration of directors to the achievement of sustainability targets. In short, where the Political Compromise proposed to limit the scope and content of the sustainability obligations in the Commission Proposal, the draft report of the rapporteur of the European Parliament proposed to expand these.

The draft report was presented to the responsible committee, the European Parliament's Committee on Legal Affairs (JURI), on 17 November 2022. JURI committee members had until 30 November 2022 to table any amendments to the draft report. The JURI committee will now try to reach an agreement on the proposed amendments and is expected to vote on the final amendments to the Commission Proposal and adopt the mandate for negotiations by the end of March 2023. The negotiating mandate is expected to be voted on at plenary in the European Parliament in May 2023. Once the European Parliament has voted on and adopted its final report, it will engage with the Council and the European Commission in 'trilogues' to negotiate a final text of the CSDDD. The timing of the adoption of the CSDDD will depend on how soon the Parliament, the Council and the European Commission reach an agreement on the final text of the

65 Explanatory Memorandum, pages 4-5.
66 *Kamerstukken II* 2020/21, 35 761, nr. 2. See S.R.N. Fernando & S.B. Garcia Nelen, 'Het Wetsvoorstel verantwoord en duurzaam internationaal ondernemen', *Ondernemingsrecht* 2021/101.
67 Annex I to *Kamerstukken II* 2022/23, 35 761, nr. 10 contains a comparison table between the Dutch bill and the Commission Proposal.
68 *Kamerstukken II* 2022/23, 35 761, nr. 10, page 4.
69 https://www.mccg.nl/publicaties/codes/2022/12/20/dutch-corporate-governance-code-2022.
70 Principle 1.1 of the Dutch Corporate Governance Code.
71 Best Practice Provision 2.1.5 of the Dutch Corporate Governance Code.
72 Best Practice Provision 1.1.1 of the Dutch Corporate Governance Code.
73 Best Practice Provision 1.1.5 of the Dutch Corporate Governance Code.
74 Dutch Corporate Governance Code, page 10.
75 https://www.europarl.europa.eu/doceo/document/JURI-PR-738450_EN.pdf.

CSDDD after May 2023. Given the significant differences between the Commission Proposal, the Political Compromise and the draft report of the JURI committee, these negotiations could take some time.

8. Conclusions

The ambitious EU initiative on sustainable corporate governance launched several years ago culminated in the Commission Proposal, which was more limited in scope, in particular in the field of corporate governance, but still quite ambitious in nature. With the Political Compromise, the proposals in the field of corporate governance have been deleted from the CSDDD. This seems to indicate that Member States are not willing to agree to any more far-reaching requirements at this point in time.

As a result, the CSDDD's key provisions seem to be moving away from the field of corporate law and towards the field of compliance, as they mainly oblige companies to put in place systems and processes to allow for appropriate reporting under the CSRD. The corporate governance of companies can ultimately also be impacted through reporting and compliance, but generally, these do not impact corporate governance in the strict sense, meaning the governance structure and the division of powers between the corporate bodies. Although the Political Compromise provides more clarity and legal certainty throughout the proposed CSDDD text, the continuing fragmentation of the corporate governance framework for companies operating in the EU market could hamper the efficient exploitation of the potential of the single market and, consequently, the transition to a sustainable economy.

In my view, the CSDDD could be more effective if we could create a level playing field by setting minimum governance standards on an EU-wide level. This could involve requiring companies to promote long-term, sustainable value creation and to take into account environmental and human rights impacts in their value chain, without linking this to director liability. In addition, these standards could provide more clarity around stakeholder engagement, by facilitating effective consultations with stakeholders that are potentially impacted by certain company decisions. Companies could be required to take the outcome of stakeholder consultations into account in their decision-making, but in the end, they should always have a choice to set aside this outcome in the interest of long-term, sustainable value creation. More clarity and guidance on these governance principles could create a level playing field, while still allowing flexibility for national governance standards.

Anne Lafarre[1]

Mandatory Corporate Sustainability Due Diligence in Global Value Chains: The Long-Awaited European Solution Compared to Existing International Standards

Ondernemingsrecht 2023/33

- **The scope of companies in terms of size and sectors should be expanded to avoid serious social damage going unnoticed. If it is impossible to involve the SMEs, then at least the scope of companies should be aligned with the Corporate Sustainability Reporting Directive ('CSRD'). Instruments such as industry initiatives can increase the feasibility of compliance for (smaller) companies.**
- **At the moment the CSDDD does not seem to contain a consolidated approach. The company-by-company approach introduces significant uncertainties and welcomes strategic behaviour for parent companies in the design of the corporate group and the Global Value Chain ("GVC"). It is recommended to adapt this and follow existing soft law standards and/or the CSRD.**
- **It seems that the CSDDD focuses too much on the ease for companies to identify and address negative impacts. As a result, the CSDDD does not fully recognise that due diligence is a pre-emptive and dynamic risk-based process aimed at meaningful stakeholder engagement. It is recommended to follow the existing soft law standards more closely.**

The European Commission published the long-awaited proposal for a directive on Corporate Sustainability Due Diligence (CSDDD) on 23 February 2022. The CSDDD not only contains important mandatory due diligence obligations for companies to prevent and address adverse impacts, but also seeks to break the current fragmentation of national requirements and company practices to create a level playing field for companies within and outside the Union. While the proposed legislative efforts definitely are to be welcomed, the current due diligence approach of the CSDDD is unlikely to reach its full potential, leaving some severe adverse impacts unidentifiable. This contribution outlines three possible points for improvement that mainly stem from deviations from the widely-recognised international due diligence framework including the UNGPs and OECD Guidelines.

1. Introduction

The European Commission ('EC') published the long-awaited proposal for a directive on Corporate Sustainability Due Diligence ('CSDDD') on 23 February 2022.[2] The CSDDD responds to the high need for companies to act responsibly and limit adverse impacts on their global value chains ('GVCs'). In the current legal and institutional frameworks there are dangerous scale mismatches that prevent dealing with today's most important challenges. The effects of climate change are global, but addressing them remains largely in the hands of national governments, which is often ineffective.[3] For example, the COP27 in 2022 shows how agreements from nearly 200 states were only able to *weaken* Glasgow's COP26 pledge to phase out polluting industry and inefficient fossil fuel subsidies.[4] We can find similar scale differences for social harms in GVCs of companies. Although there certainly are several multinational companies ('MNCs') showing leadership in responsible business conduct ('RBC'),[5] there are no global mandatory rules to ensure that stakeholders affected by corporate activities are treated with respect.[6] Several authors signal that national laws in host states may be flawed and poorly enforced.[7] Others argue that, even when corporate liability can be imposed, the principle of limited liability can allow MNCs to shift risk dispro-

1 Anne Lafarre MSc is associate professor at Tilburg Law School, Tilburg University, the Netherlands.

2 European Commission. Proposal for a Direction of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 COM (2022) 71 final (23 February 2022) ('Commission Proposal').

3 J.G. Ruggie, 'The Social Construction of the UN Guiding Principles on Business and Human Rights', in: *Research Handbook on Human Rights and Business* (S. Deva & D. Birchall, eds.) Edward Elgar (2020); A.J.F. Lafarre & S.J. Rombouts, 'Introductie Themanummer Duurzaamheid: De rol van het recht in een duurzame samenleving', *WPNR* 2023/7407.

4 C. Hodgson, COP27 ends in tears and frustration: 'The world will not thank us', *Financial Times* (20 November 2022).

5 A.J.F. Lafarre & S.J. Rombouts, 'Towards Mandatory Human Rights Due Diligence: Assessing Its Impact on Fundamental Labour Standards in Global Value Chains', 13(4) *European Journal of Risk Regulation* 567-583 (2022); J.G. Ruggie, C. Rees & R. Davis, 'Ten Years After: From UN Guiding Principles to Multi-Fiduciary Obligations', 2 *Business and Human Rights Journal* 179-197 (2021).

6 J.G. Ruggie, 'Multinationals as global institution: Power, authority and relative autonomy', *Regulation & Governance*, 12(3), 317-333 (2018).

7 For instance, C. van Dam, 'Tort Law and Human Rights: Brothers in Arms – On the Role of Tort Law in the Area of Business and Human Rights', 221 *Journal of European Tort Law* (2011).

portionately to undercapitalised subsidiaries,[8] making them "judgment proof".[9]

This, however, does not mean that there are currently no normative international instruments that recognise the duties and responsibilities of MNCs. The adoption of the Guiding Principles on Business and Human Rights ('UNGPs') by the UN Human Rights Council in 2011[10] marked the first time that the United Nations ('UN') issued official guidance to states and enterprises (including companies), recognising that they are both responsible for respecting and protecting human rights.[11] The UNGPs need to be considered in conjunction with the complementary OECD Guidelines.[12] Following this international framework that is discussed in more detail in Section 3 of this article, companies need to carry out due diligence to avoid and address adverse impacts, including enabling remediation for victims, not only for their direct activities, but also for business relationships in their GVCs. The OECD Due Diligence Guidance provides practical support for the implementation of due diligence.[13]

With their endorsement by the UN, the UNGPs should in any case not be considered pure voluntarism.[14] However, the UNGPs – and the OECD Guidelines – are soft law, thus not legally binding. This means that there is no legal oversight or enforcement mechanism for the UNGPs. Yet, these normative principles are considered to have intrinsic persuasive power and can inspire or justify prescribed conduct.[15] States encourage the integration of the UNGPs in corporate practices via National Action Plans ('NAPs') and National Contact Points ('NCPs') that handle non-judicial grievance processes.[16]

Despite their international recognition, it seems that the UNGPs did not bring forward the desirable improvements.[17] German and Dutch studies, for instance, show slow due diligence adoption rates.[18] MNCs that can be considered due diligence 'leaders' establish their policies in line with this international framework. By identifying and addressing the underlying causes, rather than just the symptoms, these companies strive to prevent and tackle significant adverse effects that they may not have previously been aware of.[19] Yet, there are also MNCs that do not comply with the UNGPs or follow a box-tick approach and are likely to miss the essence of these principles. Due to these widely differing corporate compliance practices and a patchwork of different requirements in emerging national regulations,[20] corporate leaders appear to be at a disadvantage and reluctant to take further action.[21]

The CSDDD aims at solving the existing scale mismatches by providing legal certainty and a level playing field for companies.[22] It not only entails mandatory due diligence

8 H. Hansmann & R. Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts', 100 *Yale Law Journal* (1991); G. Skinner, 'Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries Violations of International Human Rights Law', 72 *Washington and Lee Law Review* 1769-1864 (2015); N. Friedman, 'Corporate Liability Design for Human Rights Abuses: Individual and Entity Liability for Due Diligence', 41(2) *Oxford Journal of Legal Studies* 289-320 (2021). For empirical evidence for the strategic use of subsidiaries, see for instance: P. Akey & I. Appel, 'The Limits of Limited Liability: Evidence from Industrial Pollution', 76 *The Journal of Finance* 5-55 (2021). See for a discussion of this empirical study the article of A.M. Pacces in this special issue, *Ondernemingsrecht* 2023/37.

9 This term stems from: S. Shavell, 'The Judgment Proof Problem', 6 *International Review of Law and Economics* 45-58 (1986). Also see; A.J.F. Lafarre & G.J.H. van der Sangen, 'Passende zorgvuldigheid in internationale handelsketens: een rechtseconomische reflectie op de voorgestelde Corporate Sustainability Due Diligence-richtlijn', *NtER* 2022 9/10; A.M. Pacces, 'Supply Chain Liability in the Corporate Sustainability Due Diligence Directive Proposal', *ECGI blog* (2022); A.M. Pacces, 'Civil Liability in the Corporate Sustainability Due Diligence Directive Proposal: A Law and Economics', *Ondernemingsrecht* 2023/37.

10 Available at: https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf. The Human Rights Council endorsed the Guiding Principles in its resolution 17/4 of 16 June 2011.

11 J.G. Ruggie, C. Rees & R. Davis, 'Ten Years After: From UN Guiding Principles to Multi-Fiduciary Obligations', 2 *Business and Human Rights Journal* 179-197 (2021).

12 OECD Guidelines for Multinational Enterprises (2011). Available at: http://dx.doi.org/10.1787/9789264115415-en. The human rights chapter of the 2011 OECD Guidelines draws on and is aligned with the UNGPs. Available at: https://mneguidelines.oecd.org/themes/human-rights.htm. Note that the OECD Guidelines are currently under revision and a public consultation is opened until 10 February 2023. See for the consultation draft: http://mneguidelines.oecd.org/consultation-draft-public-consultation-targeted-update-of-the-oecd-guidelines-for-multinational-enterprises.pdf.

13 OECD Due Diligence Guidance for Responsible Business Conduct (2018). Available at: https://www.oecd.org/investment/due-diligence-guidance-for-responsible-business-conduct.htm.

14 J.G. Ruggie, C. Rees & R. Davis, 'Ten Years After: From UN Guiding Principles to Multi-Fiduciary Obligations', 2 *Business and Human Rights Journal* 179-197 (2021).

15 J.G. Ruggie, C. Rees & R. Davis, 'Ten Years After: From UN Guiding Principles to Multi-Fiduciary Obligations', 2 *Business and Human Rights Journal* 179-197 (2021), p. 181.

16 For the Dutch NAP, see: https://www.government.nl/topics/responsible-business-conduct-rbc/national-action-plan-on-business-and-human-rights. NCPs are offices set up by governments that have adhered to the OECD Guidelines. See: https://mneguidelines.oecd.org/OECD-Guidelines-for-MNEs-NCP-FAQ.pdf.

17 European Commission Directorate-General for Justice and Consumers, Francisca Torres-Cortés, Camille Salinier, Hanna Deringer et al., *Study on due diligence requirements through the supply chain: final report*, Publications Office (2020). Available at: https://data.europa.eu/doi/10.2838/39830.

18 German Federal Foreign Office, 'Monitoring the National Action Plan for Business and Human Rights', (13 October 2020), https://www.auswaertiges-amt.de/en/aussenpolitik/themen/aussenwirtschaft/wirtschaft-und-menschenrechte/monitoring-nap/2131054; Dutch Ministry of Foreign Affairs, 'Evaluation and Revision of policy on Responsible Business Conduct', https://www.government.nl/topics/responsible-business-conduct-rbc/evaluation-and-renewal-of-rbc-policy. Also see J.G. Ruggie, C. Rees & R. Davis, 'Ten Years After: From UN Guiding Principles to Multi-Fiduciary Obligations', 2 *Business and Human Rights Journal* 179-197 (2021), p. 192.

19 J.G. Ruggie, C. Rees & R. Davis, 'Ten Years After: From UN Guiding Principles to Multi-Fiduciary Obligations', 2 *Business and Human Rights Journal* 179-197 (2021), p. 187.

20 Recently, various regulatory initiatives were introduced. Including the French Vigilance Law from 2017 (*Loi 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre*), the German Supply Chain Due Diligence Act of 2021 (*Gesetz über die unternehmerischen Sorgfaltspflichten zur Vermeidung von Menschenrechtsverletzungen in Lieferketten*), and the Norwegian Transparency Act of 2021 (*Lov om virksomheters åpenhet og arbeid med grunnleggende menneskerettigheter og anstendige arbeidsforhold (åpenhetsloven), LOV-2021-06-18-99*).

21 CSDDD, p. 13.

22 CSDDD, p. 3.

obligations to *ex ante* prevent and deter companies from committing adverse impacts, with its legal basis in Articles 50 and 114 Treaty on the Functioning of the European Union ('TFEU') the CSDDD also seeks to break through the fragmentation caused by national legislative efforts. And with its proposed extraterritorial effects, the EC wants to create equal norms for European and non-European companies that meet certain standards. Yet, the Commission Proposal shows that the CSDDD is a product of compromise. For instance, the EU Regulatory Scrutiny Board heavily criticised earlier versions of the CSDDD, *inter alia* stating that the problem description was vague and did not provide convincing evidence that companies, and small and medium-sized enterprises ('SMEs') in particular, do not already sufficiently take into account sustainability matters or have insufficient incentives to do so.[23] The many responses across the board reveal that significant amendments can be expected during the legislative process. At the time of writing, the latest state of affairs in the regulatory process includes two documents: i) a draft report of the European Parliament ('EP') of 7 November 2022 from rapporteur Lara Wolters,[24] and; ii) the adopted position by the Council of the European Union ('Council') of 30 November 2022 that was adopted on 1 December 2022 ('Political Compromise').[25] The CSDDD will be the subject of negotiations that could that can be difficult: whereas the Political Compromise weakens the Commission Proposal, the EP seems to want to go several steps further. Some references are made to both documents, but this article primarily focuses on the Commission Proposal of February 2022.[26]

In this contribution, I outline some shortcomings related to the due diligence obligations in the Commission Proposal, particularly in relation to the current soft law framework, and propose solutions. Section 2 briefly discusses the due diligence obligations of the CSDDD. Afterwards, I return to the existing soft law framework including the UNGPs and OECD Guidelines in Section 3: ideally, the due diligence requirements in the CSDDD are aligned as much as possible and desirable with the existing soft law framework to leverage the existing knowledge and current due diligence practices of corporate leaders and stakeholders. Although there are many other important considerations for the European legislature, for instance in selecting the right enforcement mechanisms to effectively enforce substantive due diligence laws and establish desirable incentives,[27] this contribution will focus on the desired contents of the due diligence obligations. Based on a comparison between the CSDDD and the existing international due diligence requirements, I highlight three possible points for improvement in Section 4. Section 5 provides concluding remarks.

2. The CSDDD

The EC explains that mandatory due diligence is key to setting incentives for corporate behaviour to ensure the EU's transition in line with the European Green Deal and UN Sustainable Development Goals.[28] These corporate sustainability due diligence obligations are categorised in six actions.[29] First of all, companies should integrate due diligence into their corporate policies and establish an appropriate due diligence policy that is updated annually.[30] Second, companies should identify actual or potential adverse impacts arising from their own activities, those of their subsidiaries and of *established business relationships*.[31] Third, companies should prevent and mitigate potential adverse impacts,[32] and bring actual adverse impacts to an end and minimize their extent using *appropriate measures*.[33] Fourth, companies should establish and maintain a complaints procedure. It must be possible for affected persons, trade unions and civil society organisations to lodge these complaints.[34] Fifth, companies should monitor the effectiveness of their due diligence policy and measures at least once a year, based on qualitative and quantitative indicators, or rather, when there are reasonable grounds to believe that significant new risks may arise that produce adverse effects.[35] Finally, companies should publicly communicate on due diligence.[36] Companies not covered by the Non-Financial Reporting Directive ('NFRD')[37] must communicate through an annual report on their website.[38]

23 Regulatory Scrutiny Board Opinion of 26 November 2021, SEC(2022) 95. Also see H.-J. de Kluiver, 'Onderneming en Duurzaamheid: over ondernemen, mensenrechten, milieu en klimaat mede in Europees perspectief', *WPNR* 2023/7407.
24 Available at: https://www.europarl.europa.eu/doceo/document/JURI-PR-738450_EN.pdf.
25 Available at: https://data.consilium.europa.eu/doc/document/ST-15024-2022-REV-1/en/pdf. For the press release, see: https://www.consilium.europa.eu/en/press/press-releases/2022/12/01/council-adopts-position-on-due-diligence-rules-for-large-companies/.
26 As negotiations are still ongoing, it is not yet possible to say whether these amendments will reach the finish line. Therefore, the references to the provisions of the CSDDD in this article refer to the Commission Proposal, unless stated otherwise. This article was written in autumn 2022, but contains updates until January 2023.
27 A.J.F. Lafarre, 'The Proposed Corporate Sustainability Due Diligence Directive: Corporate Liability Design for Social Harms', *European Business Law Review* 34, no. 2 (2023): 213-238 (forthcoming); A.M. Pacces, 'Supply Chain Liability in the Corporate Sustainability Due Diligence Directive Proposal', *ECGI blog* (2022).
28 CSDDD, p. 1.
29 Article 4(1) CSDDD.
30 Article 5 CSDDD.
31 Article 6 CSDDD.
32 Article 7 CSDDD.
33 Article 8 CSDDD.
34 Article 9 CSDDD.
35 Article 10 CSDDD.
36 Article 11 CSDDD.
37 Directive 2014/95/EU of 22 October 2014 amending Directive 2013/34/EU as regards the publication of non-financial information and information on diversity by certain large companies and groups. Its successor, the Corporate Sustainability Reporting Directive ('CSRD') was published in the *Official Journal* on 16 December 2022. Directive (EU) 2022/2464 of 14 December 2022.
38 Article 11 CSDDD.

2.1 *Appropriate Measures*

The EC explains that the mandatory due diligence obligations include *obligations of means* because the CSDDD "does not require companies to guarantee, in all circumstances, that adverse impacts will never occur or that they will be stopped".[39] The EC thus recognises that companies are not always in the position to stop adverse impacts, for instance when these impacts result from state intervention. Therefore, the company should take *appropriate measures* that can reasonably be expected to result in the prevention or minimisation of adverse impacts.[40]

The appropriate measures for potential adverse effects that companies should take are listed in Article 7 CSDDD, including developing and implementing a 'preventive action plan' in consultation with affected stakeholders, and negotiating contractual assurances of direct business relationships and their partners (contractual cascading). If potential adverse effects cannot be prevented or adequately mitigated by these aforementioned appropriate measures, the company should refrain from entering into new or expanding existing relationships related to those adverse effects.[41] The company should also temporarily suspend the business relationship with the business partner while the company makes prevention and minimisation efforts, if there is a reasonable expectation that these efforts will succeed in the short term.[42] If the potential adverse impact is severe, the company should terminate the business relationship in relation with the concerned activities.[43] When it comes to actual adverse effects, more or less the same appropriate measures apply but the company must draw up a 'corrective action plan' which is developed in consultation with the affected stakeholders.[44] Companies are also obliged to neutralise the adverse effects or limit their extent, including through the payment of financial compensation, proportionate to the significance and scale of the adverse impact and the contribution of the respective company.[45]

2.2 *Established business relationships*

The CSDDD limits the due diligence obligations to a company's own operations, the operations of their subsidiaries, and the related activities of upstream and downstream *established business relationships* of the company.[46] Business relationships are defined as relationships with a contractor, subcontractor or any other legal entities ('partner') with whom the company has a commercial agreement or to whom the company provides financing, insurance or reinsurance,[47] or that performs business operations related to the products or services of the company for or on behalf of the company.[48] An *established* business relationship is defined as a direct or indirect business relationship that is durable or that is expected to be durable, and does not represent a negligible or merely ancillary part of the value chain.[49] From this, it follows that the CSDDD's scope does not include the full GVC.

2.3 *Scope of Companies*

Another limitation of the due diligence obligations involves the scope of companies. Private and public limited liability companies fall within the CSDDD's scope provided that they exceed certain thresholds (that seem to be not on a consolidated but on an individual company basis, see Section 4.2 in this article). Companies must have more than 500 employees and a worldwide turnover of 150 million euros (group 1 companies),[50] or more than 250 employees and a worldwide turnover of more than 40 million euros if at least 50% of this turnover is generated in certain high-risk sectors (group 2).[51] These sectors include textiles, agriculture, and extraction of minerals.[52] Finally, the CSDDD also applies to companies in third countries that exceed certain thresholds[53] of turnover in the EU.

2.4 *Adverse Impacts covered*

The CSDDD includes both human rights issues (such as forced labour, child labour, inadequate workplace health and safety, exploitation of workers, etc.) and environmental impacts (such as greenhouse gas emissions, pollution, biodiversity loss, and ecosystem degradation, etc.). These are defined in selected international conventions listed in the Annex to the CSDDD, including violations of rights and prohibitions included in international human rights agreements (Part I Section 1 of the Annex), the violation of 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).

3. **Existing international due diligence standards**

In order to be able to explore the CSDDD's alignment with the existing international due diligence standards, I will now first give a brief introduction to the latter. International due diligence requirements can be traced back to a 2008 report by Harvard Kennedy School Professor John Ruggie[54]

39 Preamble 15 CSDDD.
40 Article 3(q) CSDDD.
41 Article 7(5) CSDDD.
42 Article 7(5)(a) CSDDD.
43 Article 7(5)(b) CSDDD.
44 Article 8(3)(b) CSDDD.
45 Article 8(3)(a) CSDDD.
46 Article 1(1)(a) jo. Article 3(g) CSDDD.
47 Article 3(e)(i) CSDDD.
48 Article 3(e)(ii) CSDDD.
49 Article 3(f) CSDDD.
50 Article 2(1)(a) CSDDD.
51 Article 2(1)(b) CSDDD.
52 Article 2(1)(b)(i)-(iii) CSDDD.
53 Article 2(2) CSDDD. Companies must have a turnover in the EU of more than € 150 million or a turnover in the EU of more than € 40 million and must have achieved at least 50% of this turnover worldwide in the risk sectors mentioned.
54 Ruggie was appointed by UN Secretary General Kofi Annan as Special Representative on Business and Human Rights in 2005. Human Rights Resolution 2005/69 (20 April 2005).

to the UN Human Rights Council.[55] The report ultimately led to the unanimous endorsement of the UNGPs in 2011.[56] The UNGPs consist of 31 Guiding Principles and are based on the interdependent and mutually reinforcing three-pillar 'Protect, Respect and Remedy' framework.[57] First of all, states have a duty to protect human rights from abuse by third parties (UNGPs 1-10). Second, enterprises have a responsibility to respect human rights (UNGPs 11-24). Third, when harm is suffered, both states and enterprises have a role to play in providing access to effective remedies (UNGPs 25-31). Whereas earlier international declarations and conventions primarily address states, the 'Respect' pillar explicitly recognises business responsibility for social harms. Enterprises should avoid adverse human rights impacts, not only in their direct activities, but also in their business relationships.[58] Under the UNGPs, the term 'business relationships' is understood to include any relationship in the GVC.[59] The responsibility can be considered a baseline expectation that is not legally binding in itself, but applies to all enterprises regardless of their size, sector, operational context, ownership and structure.[60]
An essential feature of the Respect pillar is that enterprises are to conduct due diligence.[61] The international framework offers a six-step due diligence framework, and although these steps are not entirely aligned with the steps included in the CSDDD, they are quite similar. These steps are: (1) to embed RBC into the enterprise's policies and management systems; to undertake due diligence by (2) identifying actual or potential adverse impacts on RBC issues, (3) ceasing, preventing or mitigating them, (4) tracking implementation and results, (5) communicating how impacts are addressed; and (6) to enable remediation when appropriate.[62] In line with the UNGP three-pillar framework, the OECD Due Diligence Guidance states that the sixth step, the provision of remedies, is not a component of the due diligence process (steps 1-5), but include separate, critical grievance and remediation processes that due diligence should enable and support. According to the OECD Due Diligence Guidance, these processes can also support due diligence by providing channels through which companies can become aware of and address adverse impacts.[63]

The OECD Due Diligence Guidance outlines eleven features that provide essential insights into how the due diligence process (steps 1-5) should be perceived and conducted. First of all, due diligence is preventative, meaning that it should aim at avoiding causing or contributing to adverse impacts, and seek to prevent adverse impacts through business relationships. Second, due diligence should be an integral part of corporate decision-making processes and risk management systems. Third, due diligence is risk-based, meaning that it should be commensurate to the severity and likelihood of the adverse impact. Fourth, due diligence can involve an ongoing risk-based prioritisation (based on the severity and likelihood of the adverse impact) where it is not feasible to address all identified impacts at once,[64] and fifth, due diligence is a dynamic process that is ongoing, responsive and changing, including feedback loops. Sixth, due diligence does not shift responsibilities, meaning that every enterprise in a business relationship has its own responsibility and there is no shift in responsibilities from states to enterprises. Seventh, due diligence involves RBC principles and standards that are consistent with domestic laws. Eighth, although *all* enterprises fall under the scope of due diligence, the nature and extent to which due diligence processes are adopted can depend on factors like the size of the business, the context of operations, the risk profile, etc. Particularly, and this relates to the ninth essential feature, SMEs may face limitations to how they can influence business relationships concerning adverse impacts. Therefore, due diligence actions need to be adapted to deal with such limitations, for instance through using "contractual arrangements, pre-qualification requirements, voting trusts, license or franchise agreements, and also through collaborative efforts to pool leverage in industry associations or cross-sectoral initiatives".[65] Tenth, meaningful engagement with relevant stakeholders characterised by two-way communication is important throughout the due diligence process.[66] Finally, ongoing communication is part of due diligence, as enterprises should account for how they identify and address actual or potential adverse impacts and should communicate accordingly.

Several authors have noted that the Commission Proposal uses some vague terms, including for example the notion of "appropriate measure". Although on the one hand, these terms can allow for flexibility for companies to take into account the context and adapt their due diligence and remediation processes accordingly,[67] on the other hand, I fully agree with the position of Roesingh et al. in this Special Issue that more detailed guidance is required when a

55 Available at: https://media.business-humanrights.org/media/documents/files/reports-and-materials/Ruggie-report-7-Apr-2008.pdf.
56 Resolution 17/4 (16 June 2011); UNGPs, p. iv.
57 J.G. Ruggie, 'The Social Construction of the UN Guiding Principles on Business and Human Rights', in: *Research Handbook on Human Rights and Business* (S. Deva & D. Birchall, eds.) Edward Elgar (2020).
58 UNGPs 11 and 13.
59 UNGP 13.
60 UNGP 14.
61 UNGPs 17-21.
62 See http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf. The differences are discussed in Section 4 of this article.
63 OECD Guidance, p. 88.
64 But, where a business is causing or contributing to an adverse impact, it should always stop the activities that are causing or contributing to the impact and provide for or cooperate in their remediation.
65 OECD Guidance, p. 18.
66 Stakeholders are persons or groups who have interests that could be affected by business activities, including for instance employees, workers' representatives, trade unions, civil society organizations, etc.
67 Reward Value, 'The Proposed Directive on Corporate Sustainability Due Diligence: A Critical Analysis', September 2022.

company is faced with civil liability risks.[68] This tension provides a clear example of the complexity of the matter that the CSDDD tries to address. Whereas the legal profession is used to thinking in terms of liability and compensation, the international soft law framework relies on 'access to remedy', which refers to "both the processes of providing remedy for an adverse impact and to the substantive outcomes (i.e. remedy) that can counteract, or "make good", the adverse impact".[69] Access to remedy is therefore broader than compensation for damages. While legal mechanisms hold importance, they may not always be deemed essential.[70] Non-judicial grievance mechanisms like the complaints procedure as required by the CSDDD[71] are important complements to legal mechanisms that can offer a flexible and accessible forum for dispute resolution that can prevent worse in certain cases.[72] For these types of remediation, a broad and flexible due diligence approach is desirable. Nonetheless, when it concerns civil liability, it is preferable to evade legal ambiguity.[73]

Where possible and desirable, the due diligence requirements in the CSDDD need to be aligned with the existing soft law framework to leverage the mutually enforcing roles given the latter's important authoritative value and international application. Close alignment allows companies covered by the CSDDD to use the established due diligence framework including its existing guidelines and sector knowledge.[74] This also includes the broad interpretation of 'access to remedy'. In turn, the CSDDD can further strengthen the international legitimacy of the UNGPs and the OECD Guidelines. Any unnecessary deviation could potentially negatively impact the due diligence practices of companies that currently go beyond the requirements of the CSDDD. The Commission Proposal deviates substantially from the established international framework on several significant aspects. The following section discusses three main points for improvement with regard to the content of the due diligence obligations.[75]

4. The CSDDD: Points for Improvement

4.1 *Too Narrow Scope of Companies*

Various deviations from the UNGPs and OECD Guidelines have to do with the scope of companies that are subject to the CSDDD. As outlined in Section 2, the CSDDD includes very large companies (group 1) and large companies that operate in three sectors that are identified as high-risk sectors, including textiles, agriculture and extraction of minerals (group 2). The stated rationale for including these three sectors is that these are covered by existing sectoral OECD guidance.[76] There is also extensive sectoral OECD guidance available for the financial sector, but this sector is expressly excluded from the CSDDD's high-risk sectors "due to its specificities".[77] For financial services, financial undertakings are only obliged to carry out due diligence before providing such services (a pre-service assessment[78]).[79] This restriction seems to be one of the focal points in the current debate: whereas the EP draft report removes this restriction entirely with Amendment 95, the Political Compromise keeps this restriction and even leaves it up to the Member States to decide whether the provision of financial services by financial undertakings is included in the due diligence obligations in the first place.[80] Note that the CSDDD also explicitly excludes SMEs receiving a financial service.[81]

These restrictions not only include deviations from the established international due diligence standards that may lead to perverse incentives to diminish existing due diligence activities, but, according to Principles for Responsible Investment ('PRI'),[82] can also make it harder for investors to comply with other European legislation. For instance, the SFDR includes the obligation to consider Principal Adverse Impacts ('PAIs') under Article 4, and it is

68 Here, the Political Compromise provides important improvements by underlining that liability requires that the company failed to comply with the obligations intentionally or negligently and that the damage is directly causally related to this failure. Political Compromise, 56.

69 OECD Guidance, p. 88. Also see UNGP 25.

70 M.Y.H.G. Erkens, 'Toegang tot remedy; recht(vaardigheid) in mondiale waardeketens', *WPNR* 2023/7407.

71 Article 9 CSDDD.

72 M.Y.H.G. Erkens, 'Toegang tot remedy; recht(vaardigheid) in mondiale waardeketens', *WPNR* 2023/7407.

73 It can be debated whether civil liability is the right enforcement mechanism of due diligence obligations: proactive prevention or act-based intervention, instead of deferring legal intervention until social harm actually occurs, is preferable for such large-scale social harms. Monitoring and enforcement by supervisory authorities and non-judicial grievance mechanisms are probably more likely to achieve this. Also see: A.J.F. Lafarre, 'The Proposed Corporate Sustainability Due Diligence Directive: Corporate Liability Design for Social Harms', *European Business Law Review* 34, no. 2 (2023): 213-238 (forthcoming).

74 To this end, it is desirable to establish European sector agreements in a 'smart mix' of regulatory instruments where the supervisory authorities stimulate companies to join these sector agreements. See: SER, 'Effective European due diligence legislation for sustainable supply chains' (2021), p. 8.

75 There is more scope for improvement. For instance, to ensure access to remedy, the complaints procedure requirement from Article 9 CSDDD can be strengthened to include an obligation to join a grievance mechanism in line with UNGP 31. This is addressed by the EP in amendments 31, 140 and 146.

76 See the list of sectoral guidance documents at: http://mneguidelines.oecd.org/sectors/.

77 CSDDD, p. 15.

78 This assessment only captures the activities of clients receiving the financial service, and of other companies belonging to the same group whose activities are linked to the contract in question. Article 3(g) CSDDD. Note that the Political Compromise made some amendments to this provision by listing the financial services that need to be included.

79 Article 6(3) CSDDD.

80 Article 2(8) CSDDD in the Political Compromise. The EP's Committee on Economic and Monetary Affairs ('ECON') has advised the EP, among other things, to delete this restriction in article 6(3) CSDDD in its draft opinion of 7 October 2022. The draft opinion was adopted in the meeting of 23-24 January 2023. See: https://emeeting.europarl.europa.eu/emeeting/committee/en/agenda/202301/ECON?meeting=ECON-2023-0123_1&session=01-24-09-00.

81 Article 3(g) CSDDD.

82 PRI, 'Position Paper: EU Corporate Sustainability Due Diligence (CSDDD) Directive' (September 2022). Available at: https://www.unpri.org/download?ac=17111.

unclear whether these PAIs are similar to the term 'adverse impacts' of the CSDDD.[83] This may lead to unnecessary confusion and complexity.
In addition to these concerns related to the financial sector, one may note that also other sectors that were already identified as high-risk sectors are not included within the scope of the CSDDD.[84] Given these deviations, it should not come as a surprise that the group 2 companies constitute an important point for improvement in the legislative process. The current selection of sectors seems arbitrary at the very least, with not all equally risky sectors being included. Moreover, limiting the scope of companies with this industry approach completely ignores the fact that *company location* also plays a major role in what can be considered high risk.

Nevertheless, the most significant limitations in the CSDDD surpass the arbitrary categorization of high-risk sectors alone. Whereas the UNGPs include all companies and take a risk-based approach to due diligence that is aligned with the size of the company, the nature of the company, the context of its operations, and the severity and probability of adverse impacts, the CSDDD first explicitly excludes all companies that do not meet the stated requirements, and only as a next step introduces the obligation for companies that meet the scope requirements to take *appropriate measures* that are in line with the severity and the likelihood of the adverse impact, and reasonably available to the company (see Section 2). The CSDDD thus fails to understand that such a risk-based approach holds for *all* companies and, moreover, that particularly smaller companies can be involved with severe adverse impacts.[85] The current approach therefore very likely leads to severe social harms being unidentified. To address this issue, I suggest that the European legislature adopts the approach taken by the Norwegian Transparency Act, which encompasses a broader range of companies and explicitly adheres to the OECD Guidelines, beyond the realm of civil liability.[86] The EC, however, claims that the CSDDD impacts SMEs indirectly, for instance via contractual assurances.[87] Not only are contractual assurances oftentimes sub-optimal (see Section 4.3), this may lead to the situation that SMEs face prescriptive due diligence requirements from larger companies, without being able to develop their own due diligence approaches suitable for their size and operations.[88]

Given its rough regulatory path, including the criticism of the Regulatory Scrutiny Board on the proportionality of the provisions in the Commission Proposal for SMEs and the many deviating opinions about the scope of companies,[89] inclusion of SMEs in the CSDDD, albeit highly recommended, probably may be highly unlikely. In the case that SMEs cannot become part of the CSDDD, it is desirable to at least align the scope of the CSDDD with the recently adopted CSRD.[90]
By utilizing a 'smart mix' of mandatory and voluntary instruments, it is possible to enhance the feasibility of (smaller) companies to comply with the due diligence requirements.[91] The Social and Economic Council of the Netherlands ('SER') provides an example of how such a mix can work in practice with the help of sector agreements (including their grievance mechanisms): companies adhering to a sector agreement that is recognised by the EC can be subject to a lighter supervisory regime that focuses on the collective level. These sector agreements should not provide safe harbours as the SER indicates, but such an approach gives "a clear and positive incentive" to companies to join them and increases the focus on learning, collaboration and support for companies.[92]

83 Article 4 of Regulation (EU) 2019/2088.
84 For instance, the EC has provided due diligence guidance for completely different sectors that can be considered high-risk, including ICT (https://op.europa.eu/en/publication-detail/-/publication/ab151420-d60a-40a7-b264-adce304e138b), and employment and recruitment agencies (https://op.europa.eu/en/publication-detail/-/publication/7fa3f4c2-9f0f-46df-b698-cdd627cabe31/language-en/format-PDF/source-search).
85 For instance, see the statement of over 100 companies and organizations to make the due diligence obligations mandatory for all businesses operating in the EU, regardless of size. Available at: https://www.business-humanrights.org/en/latest-news/making-eu-legislation-on-mandatory-human-rights-and-environmental-due-diligence-effective/.
86 See Section 3(a) jo. 4 Norwegian Transparency Act. Also the Dutch Child Labor Due Diligence Act of 2019 did not limit the application of the due diligence obligations to large companies only. The Act did not enter into force and at the moment of writing, it is unclear what will happen. Note that another Dutch legislative initiative, the initiative bill *Verantwoord en duurzaam internationaal ondernemen*, has been submitted to the Dutch House of Representatives in November 2022. See: https://www.tweedekamer.nl/kamerstukken/wetsvoorstellen/detail?cfg=wetsvoorsteldetails&qry=wetsvoorstel%3A35761. There is currently a fierce discussion on this initiative bill. For more information, see the article of T. Lambooy in this special issue, *Ondernemingsrecht* 2023/30.
87 Preamble 47 CSDDD.
88 Shift, 'Shift's Analysis of the EU Commission's Proposal for a Corporate Sustainability Due Diligence Directive' (March 2022).
89 Note that the Political Compromise actually reduces the scope of the CSDDD up to three years from the entry into force so that it will first apply to "very large companies that have more than 1000 employees and EUR 300 million net worldwide turnover, or 300 million net turnover generated in the Union for non-EU companies 3 years from the entry into force" (p. 5). In contrast, the EP draft report of 7 November 2022 significantly lowers the thresholds in group 1 to 250 employees on average and a net worldwide turnover of more than € 40 million, and group 2 to 50 employees and € 8 million net worldwide turnover and at least 30% generated in the high-risk sectors (Amendments 51-52).
90 Directive (EU) 2022/2464 of 14 December 2022.
91 UNGPs, p. 5.
92 SER, 'Effective European due diligence legislation for sustainable supply chains' (2021), p. 14. Available at: https://www.ser.nl/-/media/ser/downloads/engels/2021/due-diligence-sustainable-supply-chains.pdf.

Finally, even if the European legislature explicitly does not want to include companies that do not meet the stated size requirements for proportionality reasons, this cannot explain why the CSDDD seems to not consider consolidated companies as the CSRD[93] and the international framework does. After all, smaller companies that are all part of the same corporate group are very likely to be able to comply with due diligence obligations at the group level. This possible point of improvement is discussed in the next section.

4.2 *A Consolidated Approach*

Whereas the OECD Guidelines take an "enterprise groups"[94] perspective, with the CSDDD's 'company-by-company' approach, the EC fails to fully recognise the existence of consolidated companies and corporate groups. Although all subsidiaries are included whether or not they are part of the GVC of their parent,[95] there are some concerns with the CSDDD's current approach.[96]

If a group of companies as a whole exceeds the thresholds in the CSDDD, but the individual companies within the group do not, the CSDDD will not apply to any of the companies in the group. Or, if only one of the companies in the group meets the thresholds, the CSDDD will only apply to the GVC of this company and not the chains of the other group companies when these chains are sufficiently distinct.[97] This company-by-company approach can lead to strategic behaviour[98] to organise the business group and GVC in such a way that the CSDDD either does not apply or only applies to a limited number of companies within the corporate group that are less risky.[99] This particularly holds for non-EU parent companies that operate in the EU via subsidiaries that do not meet the size requirements.[100]

The definition of a subsidiary in the CSDDD refers to the definition of 'controlled undertaking' under the Transparency Directive.[101] The Transparency Directive also includes indirect subsidiaries (subsidiaries of subsidiaries) via Article 2(2), but it is unclear whether the CSDDD also takes into account this supplementary provision.[102] In addition, subsidiaries within a group that operates in different Member States can face different due diligence obligations and public authorities as Member States may implement the CSDDD in different ways. And, several companies within the same group may be obliged to conduct the same due diligence actions.[103] The Political Compromise seems to solve the latter issue by adding a provision on 'due diligence on a group level' so that subsidiaries may decide that the due diligence obligations shall be fulfilled by the parent company.[104] It should be noted that the Political Compromise acknowledges the need for the EC to assess and evaluate the possibility of replacing the company-by-company approach with a consolidated approach.[105] It would be recommended to address these drawbacks prior to the CSDDD's adoption.

4.3 *Avoid a 'Convenience' Approach*

Principle IV(3) of the OECD Guidelines states that enterprises should seek ways to prevent or mitigate adverse human rights impacts that are directly linked to their business operations, products or services by a business relationship, even if they do not contribute to those impacts. The OECD Guidance explains that due diligence should cover all types of business relationships.[106] Together with the "enterprises" definition,[107] this means that also the subsidiaries and GVCs of subsidiaries are covered. In contrast, the CSDDD limits the due diligence obligations to companies' 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*. This seems to exclude the GVCs of subsidiaries in a corporate group that are not part of the GVC of the parent company.[108]

Whereas the international soft law framework clearly aims at preventing the most severe harms wherever in the GVC using the risk-based approach (see Section 3), the CSDDD focuses more on the *ease* for companies to be able to identify and address adverse impacts *inter alia* with its narrow definitions of 'established business relationship' and 'value chain'. This, what I would call a '*convenience approach*' to due diligence,[109] is also reflected in the heavy emphasis on contractual guarantees that may be easy to use but have proven not to always be the most effective

93 Articles 19a and 29a of Directive 2013/34/EU.
94 Principle II, Commentary 9, p. 21. Also see Principle IV, Commentary 43, p. 33. The OECD Guidance adds that "enterprises" include "all the entities within the MNE group – parent and local entities, including subsidiaries", p. 9.
95 Article 3(d) jo. 6(1) CSDDD.
96 S.B. Garcia Nelen, 'Het voorstel voor een Europese Corporate Sustainability Due Diligence-richtlijn', *Ondernemingsrecht* 2022/41.
97 Article 3(g) CSDDD.
98 A.J.F. Lafarre & G.J.H. van der Sangen, 'Passende Zorgvuldigheid in Internationale Handelsketens: Een Rechtseconomische Reflectie op de Voorgestelde Corporate Sustainability Due Diligence-Richtlijn', *NtER* 2022 9/10. Also see the article of A.M. Pacces in this special issue, *Ondernemingsrecht* 2023/37.
99 K.E. Sørensen, 'Corporate Sustainability Due Diligence in Groups of Companies', 19(5) *European Company Law* 119-130 (2022).
100 A.M. Pacces, 'Supply Chain Liability in the Corporate Sustainability Due Diligence Directive Proposal', *ECGI blog* (2022).
101 Article 2(1)(f) of Directive 2004/109/EC.
102 K.E. Sørensen, 'Corporate Sustainability Due Diligence in Groups of Companies', 19(5) *European Company Law* 119-130 (2022).
103 K.E. Sørensen, 'Corporate Sustainability Due Diligence in Groups of Companies', 19(5) *European Company Law* 119-130 (2022).
104 Article 4a CSDDD.
105 Political Compromise, p. 5.
106 OECD Guidance, p. 10.
107 The OECD Guidance states that "enterprises" include "all the entities within the MNE group – parent and local entities, including subsidiaries", p. 9.
108 K.E. Sørensen, 'Corporate Sustainability Due Diligence in Groups of Companies', 19(5) *European Company Law* 119-130 (2022). Amendment 71 of the EP draft report seems to solve this issue.
109 Also see Reward Value, 'The Proposed Directive on Corporate Sustainability Due Diligence: A Critical Analysis', September 2022.

due diligence measures.[110] Where they lead to ticking boxes, these measures can create a false impression of due diligence compliance and dangerously limit the observability of harmful acts. In addition, the restriction to 'established business relations' – like the company-by-company approach – can also lead to strategic mapping of GVCs: companies may simply try to avoid these types of relationships for more risky activities.

The Political Compromise recognises that the CSDDD should be more aligned with the existing international standards and completely removes the concept of 'established business relationship'. The same holds for the EP draft report.[111] The Political Compromise introduces a new Article 6a that includes the prioritisation of adverse impacts. Whereas at first glance, it can be welcomed that the Council's aim is to strengthen the alignment with the UNGPs, a close reading of its negotiation position shows that its concept of value chain (now labelled as 'chain of activities') provides an even more restrictive approach. In contrast, the EP sticks to the 'value chain' notion and expands the definition.[112]

Finally, as discussed in Section 3, due diligence should involve meaningful engagement with relevant stakeholders characterised by two-way communication.[113] In contrast, also here the CSDDD seems to focus too much on corporate convenience and makes stakeholder consultation optional in Articles 6(4) and 8(3)(b) with the words 'where relevant' and without considering that stakeholder engagement should be meaningful.[114] The international soft law framework puts stakeholders involvement in the centre of due diligence, recognising that companies can only assess their adverse impacts accurately when they seek to understand the concerns of (potentially) affected stakeholders by consulting them directly in a manner that takes into account (language) barriers to effective engagement.[115] Also here, the CSDDD fails to fully recognise that due diligence is mostly a preventative, dynamic and consultative process.

5. Conclusion

MNCs are of great importance to the sustainable development of host countries, but at present there is no global framework of mandatory rules for RBC. The CSDDD aims to solve this scaling mismatch that currently prevents adequate measures against serious adverse impacts in GVCs. To this end, the CSDDD not only contains important mandatory due diligence obligations for companies to prevent and address adverse impacts, but also seeks to break the current fragmentation to create a level playing field for companies within and outside the Union. While the proposed legislative efforts definitely are to be welcomed, the current due diligence approach of the CSDDD is unlikely to reach its full potential, leaving some severe adverse impacts unidentifiable. The three points for improvement discussed in this contribution mainly stem from deviations from the generally recognised international soft law framework, including the UNGPs and OECD Guidelines.

First of all, the CSDDD currently takes too narrow a scope of companies in terms of size and sectors. The Commission Proposal thus fails to understand the important risk-based due diligence approach that applies to all companies, nor that smaller companies in particular can be associated with serious adverse impacts. Second, in addition, the individual company approach brings significant uncertainties and welcomes strategic behaviour for parent companies in the corporate group and GVC design. Third, and probably because of the fierce debate prior to its adoption, the CSDDD perhaps focuses too much on the ease for companies to identify and address adverse impacts. Here, the CSDDD does not fully recognise that due diligence is a pre-emptive and dynamic risk-based process that focuses on meaningful stakeholder engagement. The recent amendments to the EP's draft report (rapporteur Lara Wolters) seem to resolve some of these shortcomings, but the strongly opposing views across the board show that it is still very unclear what the CSDDD will ultimately look like.

110 A.J.F. Lafarre, 'Mandatory Corporate Sustainability Due Diligence in Europe: The Way Forward', *ECGI blog* (2022); Shift, 'Shift's Analysis of the EU Commission's Proposal for a Corporate Sustainability Due Diligence Directive' (March 2022). Moreover, article 22 CSDDD that in principle excludes liability where a company negotiates contractual assurances appears to be contrary to UNGP 17 that excludes such safe havens.

111 Amendment 73.

112 Amendment 74.

113 UNGP 18(b); OECD Guidance.

114 The EP draft report solves these discrepancy in Amendments 80, 96, 99, 119 and 122.

115 Commentary to UNGP 18.

Menno Baks & Kitty Lieverse[1]

Supervision and Enforcement under the CSDDD

Ondernemingsrecht 2023/34

- **The main norms imposed by the CSDDD are not specific. They leave room for interpretation and proportionate application. Clarity by means of guidelines, or otherwise, which enables an in-scope entity to determine which measures have to be taken to ensure compliance has to be provided beforehand to allow for public enforcement (par. 3.2).**
- **A centralised system of supervision with an EU institution as the supervisory authority, supported by the relevant national supervisory authorities, would facilitate a harmonised application of the CSDDD and a level-playing field (par. 3.3).**
- **The filing of substantiated concerns for an assessment by the relevant supervisory authorities under Article 19 CSDDD should be limited to a person with a legitimate interest and only after the internal complaints procedure has been applied (par. 3.5).**

The CSDDD requires Member States to ensure that a public law system of oversight with regard to obligations under this Directive will be introduced. In this article, we first briefly discuss the scope of the Directive and the main obligations it introduces for in-scope entities. On this basis, the options for how to organise this supervision for the Netherlands are discussed. This analysis will be provided on the basis of an inventory of the requirements for supervision as posed by the Directive. The options include the introduction of a new, dedicated supervisory authority and the appointment of one or more existing supervisory authorities. We will also discuss whether the filing of substantiated concerns with a supervisory authority should be preceded by the filing of a complaint with the in-scope entity on the basis of its complaints procedure.

1. A Brief Introduction to the Scope of the CSDDD and the Main Obligations for In-scope Entities

1.1 *Scope of the CSDDD*

The CSDDD[2] will be applicable to large companies formed in the EU as well as companies formed in a third country with significant operations in the Union, provided certain turnover and employee threshold criteria have been met.[3]

In the Political Compromise it is proposed that Member States will have discretion whether or not to include the provision of financial services (in other words: the downstream part of the chain of activities) by regulated financial undertakings (as defined in the Directive[4]) when transposing the CSDDD into national legislation.[5] If a Member State decides to include the provision of financial services by regulated financial undertakings, the “chain of activities” of such regulated financial undertakings is specified in Article 3(g) CSDDD and shall not cover SMEs, natural persons and households receiving the services.[6]

1.2 *Main Obligations for In-scope Entities*

The public law supervision, which is the subject of this contribution, concerns compliance with Articles 6 through 11 and Article 15 CSDDD. Below, we will briefly indicate the main features of these obligations.

The Directive introduces obligations for in-scope entities with regard to actual and potential negative impacts on human rights and the environment with regard to their own activities, the activities of their subsidiaries and the activities in the value chain carried out by business partners of the in-scope entity.[7] This is founded in the require-

1 Menno Baks is attorney-at-law in Amsterdam (Loyens & Loeff). Kitty Lieverse is professor financial regulatory laws at Radboud University (Nijmegen), deputy-judge at the The Hague Court of Appeal, attorney-at-law in Amsterdam (Loyens & Loeff) and member of the editorial board of *Ondernemingsrecht*.

2 The references in this article to the CSDDD or the Directive are to the proposal of the European Commission of 23 February 2022 (COM(2022) 71 final), unless indicated otherwise. As at 1 January 2023, the most recent development is the political compromise by the Council of the European Union on 30 November 2022 (the Political Compromise). Reference is made to the Interinstitutional File 2022/0051(COD).

3 Article 2, par. 1 and 2 CSDDD.

4 See Article 3, point (a) under (iv). This list includes *inter alia* credit institutions, investment firms, alternative investment fund managers, UCITS managers, insurers and reinsurers, pension funds (reference is also made to Article 2, par. 6 of the Political Compromise for a carve out), payment institutions, e-money institutions, crowdfunding service providers and crypto-assets service providers. However, alternative investment funds and UCITS as such are excluded from the CSDDD (Article 2, par. 7 of the Political Compromise).

5 Article 2, par. 8 of the Political Compromise effectively *excludes* the business partners to which financial services are provided, unless a Member States decides otherwise. Reference is made to item 20-24 of the introductory notes and Recital (19) of the Political Compromise. If this option is used by a Member State, it means that for financial sector entities the HREDD requirements only relate to the upstream business partners.

6 Article 2, par. 8, final paragraph in conjunction with Article 3(g), as clarified in Recital (19) of the Political Compromise.

7 The initial proposal contained the concept of an ‘established business relationship’. The Political Compromise speaks of ‘business partner’ which is defined in Article 3, point (e) of the Political Compromise.

ment for entities to exercise due diligence in respect of human rights and the environment ('HREDD'), with the following six steps as stipulated by Article 4 CSDDD:
(a) integrating due diligence into their policies and risk management systems in accordance with Article 5 CSDDD;
(b) identifying actual or potential adverse impacts in accordance with Article 6 CSDDD;
(c) preventing and mitigating potential adverse impacts, and bringing actual adverse impacts to an end or, where the adverse impact cannot be brought to an end, minimising their extent in accordance with Articles 7 and 8 CSDDD;
(d) establishing and maintaining a complaints procedure in accordance with Article 9 CSDDD;
(e) monitoring the effectiveness of their due diligence policy and measures in accordance with Article 10 CSDDD;
(f) publicly communicating on due diligence in accordance with Article 11 CSDDD.

It is important to note that a key concept in compliance with Articles 6, 7 and 8 CSDDD is for in-scope entities to take appropriate measures. A measure is an 'appropriate measure' when it 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*".[8] In the legislative process, it has been recognised that it may not be feasible for in-scope entities to address all adverse impacts they have identified all at once. In the Political Compromise it is therefore proposed that in-scope entities are required to prioritise those adverse impacts arising from their own operations, those of their subsidiaries or those of their business partners. Such prioritisation must be based on the severity and likelihood of the adverse impact, whereby its severity must be based on the gravity, the number of persons or the extent of the environment affected and the difficulty to restore the situation prevailing prior to the impact.[9] In our view such prioritisation may be difficult to assess in practice, but would be a welcome addition as it introduces some proportionality in applying the Directive.

Furthermore, in-scope entities that are subjected to the obligations of the Directive merely because of their size[10] must adopt a climate change action plan (a 'CCAP') in accordance with Article 15 CSDDD in order to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and the commitments in relation to combating climate change.

8 Article 3, point (q) CSDDD.
9 Article 6a of the Political Compromise.
10 Reference is made to Article 2, par. 1 sub (a) and par. 2 sub (a) CSDDD.

2. An Inventory: the CSDDD Requirements on Public Supervision

To ensure observance with the due diligence requirements under the Directive, Member States are required to designate one or more supervisory authorities to supervise compliance with the obligations laid down in the national laws that implement Articles 6 to 11 and Article 15 CSDDD.[11] If more than one supervisor is designated,[12] the respective competencies of those authorities must be clearly defined. Further, the implementing laws must then provide for close and effective cooperation between the multiple supervisory authorities.[13] The Directive explicitly allows for existing financial market supervisors for the supervision of regulated financial undertakings to be designated as supervisor for the purposes of the Directive.[14]

For companies that are in the scope of the Directive[15] and that are formed in accordance with the legislation of a Member State, the competent authority is that of the Member State in which the company has its registered office.[16] This is a system of 'home-country' supervision. However, the due diligence aspects which are to be supervised extend to subsidiaries and business partners that are likely to be established, at least in part, in other countries than the company itself. As a result, the supervision under the Directive will include cross-border aspects. This is recognised in Article 18, par. 3 CSDDD: if 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, par. 2 CSDDD. Another cross-border aspect is the host-country supervision that is required for in-scope companies that are formed in accordance with the legislation of a third country. For these third-country companies, the competent authority shall be that of the Member State in which such company has established a branch. In the event of no or of multiple branches, the linking pin to the competent supervisory authority is the Member State where most of the net turnover in the Union is generated in the relevant financial year.[17] Notably, there is a certain flexibility for a third-country company to change to another supervisory authority.[18] It is envisaged that the supervisory authority or authorities appointed in a Member State shall form part of a network of the other European supervisors to enable cross-border cooperation.[19] This network also has a role in assisting in case of any doubt or discussion on the attribu-

11 Article 17, par. 1 CSDDD. Notably, this does not include Article 5 CSDDD.
12 Article 17, par. 1 and 4 CSDDD explicitly allow for this.
13 Article 17, par. 4 CSDDD.
14 Article 17, par. 5 CSDDD.
15 Reference is made to Article 2 CSDDD and to par. 1.1 above.
16 Article 17, par. 2 CSDDD.
17 Article 17, par. 3 CSDDD.
18 Article 17, par. 3, part 2 CSDDD.
19 Article 21, par. 7 CSDDD.

tion of competence between different supervisory authorities.[20]

The supervisory authorities are required to operate independently. Further, their operations must be impartial, transparent and with due respect for obligations of professional secrecy.[21] Member States must ensure that the supervisory authorities have adequate powers and resources to carry out the tasks assigned to them under the Directive.[22] This includes the power to request information and carry out investigations under the Directive. In respect of the investigative powers, the supervisory authority should adhere to the national law of the Member State in which the inspection is carried out. The default rule is that a prior warning of such an investigation is given to the company. This is not required, however, where prior notification hinders the effectiveness of the inspection.[23]

On enforcement, the starting point is for the supervisory authority to focus on remediation. Article 18, par. 4 CSDDD, provides that if a supervisory authority identifies a failure to comply with national provisions adopted pursuant to the Directive, it shall grant the company concerned an appropriate period of time to take remedial action, if such action is possible. However, if remedial action is taken, this 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 CSDDD, respectively.[24] Article 18, par. 5 CSDDD, prescribes that the supervisory authorities must have at least the powers to order the cessation of infringements, the abstention from any repetition of the relevant conduct, remedial action proportionate to the infringement and necessary to bring it to an end, to impose pecuniary sanctions[25] and to adopt interim measures to avoid the risk of severe and irreparable harm.[26] Member States must 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.[27]

As to the trigger for an investigation, an investigation may be initiated at the initiative of the supervisory authority or as a result of 'substantiated concerns' communicated to it pursuant to Article 19. In the latter case, the supervisory authority must consider 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.[28] Article 19 CSDDD explicitly provides a role to the public for the initiation of an investigation. Basically, the implementation of the Directive should provide for natural and legal persons to be able 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 the Directive. On the basis of Article 23 CSDDD, Directive (EU) 2019/1937[29] applies to the reporting of all breaches of this Directive and the protection of persons reporting such breaches. The supervisory authority is not at liberty to ignore a report of substantiated concern.[30] There is a certain threshold for filing substantiated concerns, namely, the presence of some objective circumstances that give reason to believe there may be non-compliance.[31] Based on Recital (65), it seems that the potential for the supervisors to receive a tip from the public on non-compliance is linked specifically to staff and employees of a company subject to the Directive: "*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 should therefore apply to the reporting of all breaches of this Directive and to the protection of persons reporting such breaches.*" If the supervisory authority does not have competence in respect of the company that is the subject of a reported substantiated concern and another supervisory authority does, the substantiated concern should be transmitted to that other authority.[32] Article 19, par. 5 CSDDD adds the element that persons who have submitted a substantiated concern *and* are having, in accordance with national law, a legitimate interest in the matter, must 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.

20 Article 21, par. 8 CSDDD.
21 Article 17, par. 8 CSDDD.
22 Article 18, par. 1 CSDDD.
23 Article 18, par. 3 CSDDD.
24 Article 18, par. 4 CSDDD.
25 As provided for in Article 20 CSDDD. This includes that the sanctions provided for must be effective, proportionate and dissuasive (par. 1). The amount of the fines must be based on the companies' turnover (par. 3, nuance to this rule is provided by Recital (54) which includes that Member States should have the flexibility to base the penalty on other criteria, such as the economic situation of the company). The Directive further adheres to a system of naming and shaming: any decision of the supervisory authorities containing sanctions related to the breach of the provisions of the Directive must be published (par. 4).
26 Article 18, par. 5 CSDDD.
27 Article 18, par. 7 CSDDD.
28 Article 18, par. 2 CSDDD.
29 This is the directive on the protection of persons who report breaches of Union law, also known as the EU Whistleblower Directive. On 24 January 2023, the Dutch Whistleblower Protection Act (*Wet bescherming klokkenluiders*) was adopted which implements the EU Whistleblower Directive into Dutch law. As of 18 February 2023, the Dutch Whistleblower Protection Act has become effective (*Stb.* 2023, 52). Reference is made to the following parliamentary documents: *Kamerstukken II* 2020/21, 35851.
30 Article 19, par. 3 CSDDD. Member States must ensure that supervisory authorities assess the substantiated concerns and, where appropriate, exercise their powers as referred to in Article 18. This follow up must be done 'as soon as possible' and the person providing the tip must be informed of the result of the assessment of their substantiated concern, along with the reasoning for it (Article 19, par. 4 CSDDD).
31 Article 19, par. 1 CSDDD.
32 Article 19, par. 3 CSDDD.

3. A Discussion: The Challenges in respect of Public Supervision in respect of the CSDDD

3.1 *Introduction*

On the basis of the indication of the scope of the Directive in respect of the addressees (the in-scope entities) and the nature of the obligations, as discussed in par. 1 and the requirements posed by the Directive on the system of public supervision and enforcement as discussed in par. 2, below we will discuss the challenges that we believe the Directive poses in respect to the implementation of the provision on supervision in the Netherlands.

3.2 *The Effectiveness of a System of Public Enforcement*

As to the inclusion in the Directive of a system of public law supervision and enforcement (basically: the requirement for Member States to appoint a supervisory authority and grant investigative and enforcement powers to such supervisory authority), the following comments can be made. The introduction of a system of public enforcement follows an earlier resolution by the European Parliament.[33] According to the proposal of the European Commission, the potential of public enforcement by means of sanctions is required to ensure compliance with HREDD and CCAP requirements.[34] This position includes that reliance on the voluntary adoption of guiding principles such as the OECD Guidelines and the UN Guiding Principles on Business and Human Rights (UNGPs) and sector agreements as part of responsible business conduct has proven to be not sufficient.[35] Public law monitoring and enforcement is a step beyond requirements in respect of transparency and reporting.[36] In short, the introduction of a system of public enforcement is advocated on the basis of the position that such system is more likely to effect the desired changes in company behaviour at this stage than non-mandatory adoption of soft laws (such as the UNPGs).[37]

While this reasoning is convincing in view of the track record on HREDD to date,[38] an important challenge that has to be mentioned in this regard relates to legal certainty. In order for legal rules to be suitable for enforcement by means of administrative sanctions, the rules must be sufficiently clear (*bepaalbaar*). If this is not the case, the imposition of enforcement measures would be in breach of the requirement of legal certainty (*rechtszekerheid*).[39] As mentioned, a system of public law enforcement is considered by various sources to be an appropriate means to effectuate the HREDD requirements.[40] However, this is based on the starting point that enforcement on the due diligence requirements is only possible after sufficient clarity has been given to companies that are in scope of the CSDDD on what is expected from them and after sufficient time has been allowed for the implementation of these requirements.[41] It is fair to say that the main norms imposed by the CSDDD are not specific.[42] Rather, these norms leave room for interpretation and proportionate application. Clarity by means of guidelines or otherwise which enables a company to determine which measures have to be taken to ensure compliance have to be provided beforehand to allow for enforcement. The potential vagueness and indeterminability of the norms in respect of HREDD are simply incompatible with a system of public enforcement. Arguably, the requirement to adopt a CCAP is more specific. This is based on the assumption that public enforcement would not include a full review of the contents and feasibility of the CCAP. Notably, the Political Compromise adds a specific limitation to Article 18, par. 1 CSDDD, to the effect that Member States shall only require supervisory authorities to supervise that the in-scope entities have adopted a CCAP.[43] The choice to implement a system of public supervision and enforcement, therefore, includes that as a minimum clarity on the scope of the enforceable requirements in respect of HREDD and the CCAP has to be provided. We note that the phased-in approach provided for in Article 30, par. 1 CSDDD, allows for time to be invested in developing clarity on the HREDD requirements and the CCAP objective.

33 Decision by the European Parliament, 10 March 2021, file 2020/2129 INL, on corporate due diligence and corporate accountability (document 52021IP0073).

34 Reference is made to recital (53) and (54) to the CSDDD.

35 Reference is made to the Study on due diligence requirements through the supply chain, Final Report, January 2020, a study for the European Commission DG Justice and Consumers, undertaken by the British Institute of International and Comparative Law (BIICL) in partnership with Civic Consulting and LSE Consulting. See also for example: S.J. Rombouts, 'De vrijwilligheid voorbij? Vier vragen over Due Diligence wetgeving', *Tijdschrift voor Arbeidsrecht in Context*, April 2022, p. 6.

36 As included in the CSRD (Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting). Arguably, the CSDR implies that in-scope companies should adopt a due diligence process and sustainability targets, rather than ensuring reporting about it, as discussed in L.K. van Dijk & J.B.S. Hijink, 'Finalisering van de Europese CSRD: een mijlpaal voor duurzaamheidsverslaggeving met grote impact op het ondernemingsrecht vanaf 2025', *Ondernemingsrecht* 2022/87.

37 See also: C.C. van Dam & M.W. Scheltema, *Options for enforceable IRBC instruments, Evaluation of legal design and enforcement of enforceable IRBC instruments*, Rotterdam: Erasmus University 2020, Chapter 5.3 and 5.4. In these Chapters, it is concluded that the optimal enforcement is in fact a combination of public and private law enforcement.

38 Reference is made to sources cited in footnote 36.

39 We refer to the concerns expressed in this regard by market parties as discussed in: D.C. Roessingh, H.F. ten Bruggencate, L.J.M. Baks & S.H.M.A. Dumoulin, 'Practical Implications of the CSDDD: A Threat to its Effectiveness', *Ondernemingsrecht* 2023/39, par. 3.

40 SER Report October 2021, *Effective European Due Diligence Legislation for sustainable supply chains*, p. 13.

41 SER Report October 2021, p. 11. *Kamerstukken II* 2021/22, 22112, nr. 3393, p. 8.

42 See for example Article 6, par. 1, referring to '*appropriate measures to identify actual and potential adverse*' impacts. This point is also made by H-J de Kluiver, 'Kroniek van het Ondernemingsrecht', *NJB* 2022/952, 29 April 2022, afl. 15, p. 1182.

43 The public enforcement of the CCAP requirement is discussed in more detail by T. Arons & M. Lokin, 'The Corporate Climate Transition Plan: How to Ensure Companies are Paris-Proof', *Ondernemingsrecht* 2023/35, par. 6.

3.3 *Which Supervisory Authority would be most suitable: National or European?*

As a starting point, the introduction of a European framework for HREDD and the adoption of CCAPs has some clear upsides compared to the pursuit of national initiatives. National approaches may differ, impacting the level playing field in Europe.[44] Also, the effectiveness of cross-border responsible business conduct is more limited if a joint European framework is lacking. A common European approach is therefore generally considered to be the preferred option.[45] At the same time, however, it is fair to note that national differences with regard to the implementation are likely to occur, notably with regard to the use of the Member State option to include the downstream business partners from the HREDD obligations for regulated financial undertakings.[46] As to the supervision and enforcement, the organisation of this at a European level would have the benefit of consistency across Europe, as a single European supervisor would be responsible for developing and executing a supervisory and enforcement structure.[47] However, this is not the option selected in the proposal by the European Commission or in the Political Compromise. As mentioned, the approach included in the Directive is of a network of national supervisory authorities. It is our view that this selection is understandable at this time, also in view of the fact that the regulatory framework of the CSDDD will be that of a directive, rather than a regulation, containing various Member State options. As commented, this is likely to result in national differences in the application of the Directive. Such national differences contribute to the logic of a selection of national supervisors, tailored to the implementation options as applied by the relevant Member State, forming a network at a European level. Similar systems are applied under other EU legislative instruments.[48] Notably, Regulations like the Prospectus Regulation[49] and the Market Abuse Regulation[50] contain provisions on the cooperation between national competent authorities and with the European Securities and Markets Authority (ESMA) as one of the European Supervisory Authorities (ESAs) in the financial sector. This cooperation plays an important role in aligning the application of these Regulations in the Member States. The experience derived from the supervision and enforcement under these Regulations shows that alignment or even convergence of supervision and enforcement between Member States takes a lot of time and effort. In the case of the Prospectus Regulation and the Market Abuse Regulation, this cooperation is facilitated to a great extent through the cooperation of national supervisors on the securities markets via ESMA. A more centralised system of supervision would in our view contribute to better harmonisation within the Union and create more of a level-playing field among the Member States. One of the existing ESAs or a new ESA could be designated as the EU supervisory authority which could of course be assisted by the relevant national supervisory authorities in the Member States. For the time being, however, no such European supervisory authority for the topics of HREDD and CCAPs will be instituted. In the meantime, the operation of national supervisory authorities and the proposed cooperation via a network bears the risk of misalignment in the supervision and enforcement between Member States which would not only prejudice the legal certainty for the market but may also negatively affect the level playing field within the Union.

3.4 *Which National Supervisory Authority would be most suitable in the Netherlands?*

The options for the designation of one or more supervisory authorities in the Netherlands vary. The first option would be the appointment of one or more existing supervisory authorities. The upside for such selection is clearly the opportunity to build on the framework of an existing organisation and expertise. On the basis of this argument, it has been proposed that the AFM would be the most eligible supervisor in the Netherlands for the requirements in respect of the CCAP, considering the concurrence with CSRD requirements.[51] The selection of such an existing supervisor allows for due consideration of cross-over effects in the supervision of obligations of the supervised entities under the CSDDD and sector-specific regulations. The financial sector would be a case at hand. If the existing financial sector supervisors (AFM and DNB) are selected to

44 Notably, the French and the German model for HREDD legislation are rather different, as summarised in the SER Report October 2021, *Effective European Due Diligence Legislation for sustainable supply chains*, p. 10.

45 SER Report October 2021, Effective European Due Diligence Legislation for sustainable supply chains, p. 10; *Kamerstukken II* 2021/22, 22112, nr. 3393, p. 4. Reference is also made to Article 1, par. 2, stating that the Directive should not reduce existing levels of protection on the basis of national laws.

46 Article 2, par. 8 of the Political Compromise; as discussed in par.1.1.

47 The establishment of a single European supervisor has been advocated in the SER Report October 2021, *Effective European Due Diligence Legislation for sustainable supply chains*, p. 11.

48 See for example the predecessor of Regulation (EU) 2017/2394 of the European Parliament and of the Council of 12 December 2017 on cooperation between national authorities responsible for the enforcement of consumer protection laws and repealing Regulation (EC) No 2006/2004. Another example is the draft regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937 (COM/2020/593 final).

49 Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.

50 Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

51 T. Arons & M. Lokin, 'The Corporate Climate Transition Plan: How to Ensure Companies are Paris-Proof', *Ondernemingsrecht* 2023/35, par. 6. Reference is further made to *Kamerstukken II* 2021/22, 36157.

supervise the implementation of the CSDDD requirements for the financial sector entities that are already subject to their supervision, this allows for 'in-house' consideration of any overlap and concurrence of CSDDD requirements with existing financial sector legislation to avoid conflicts, *i.e.* in respect of fit and proper testing of policy managing directors and supervisory directors and requirements in respect of controlled business operations. However, this reasoning is less convincing if it is assumed that the Netherlands would opt for a limited inclusion of regulated financial undertakings on the basis of Article 2, par. 8 of the Political Compromise. In that case, there will be less concurrence between financial sector legislation and the CSDDD (because of the exclusion of the downstream business partners from the HREDD). The appointment of an existing supervisor requires an extension of tasks to include supervision on the basis of the Directive. The national efforts to date in respect of mandatory due diligence in the field of HREDD and a duty of care in this regard, seem to indicate that of the existing supervisory authorities, the ACM is the most obvious choice. In any event, the original proposal for the Dutch Child Labour Due Diligence Act (*Wet zorgplicht kinderarbeid*)[52] referred to the ACM as the supervisory authority.[53] This reference was deleted in a revised proposal that included that a supervisor was to be appointed by Decree.[54] To date, no follow up was given to select and appoint a supervisor under the *Wet zorgplicht kinderarbeid*. In the legislative history, reference is made to certain reluctance on the side of the ACM to be appointed as supervisor under this Act, based on the novelty of the task.[55] The recently filed proposal for the *Wet verantwoord en duurzaam internationaal ondernemen*,[56] returns to the starting point of the *Wet zorgplicht kinderarbeid* and includes that the ACM is to be appointed as supervisor. This selection in favour of the ACM is substantiated by reference to the proper functioning of markets and market practices to be the existing focal point of the ACM, making the ACM a logical choice.[57] At the same time, however, it is recognised that the mandatory due diligence requirements constitute a new set of rules that requires the development of expertise and track record within the ACM.[58] In a general parliamentary debate regarding international responsible and sustainable business conduct, the suggestion was raised that, considering its focus on human rights, the Netherlands Institute for Human Rights (*College voor de Rechten van de Mens*) could also be appointed as the supervisory authority or could otherwise at least assist the relevant supervisory authority in its supervision.[59] In this regard, it is fair to note that the CSDDD covers not only the topic of human rights due diligence, but environmental due diligence as well. Further, expertise in respect of the development of CCAPs is required, in view of the supervision on Article 15. There has also been an expression of a preference for a national new, dedicated supervisor in this field.[60] In this regard, we refer to the considerations in respect of the introduction of a new supervisor in respect of algorithms as of 1 January 2023.[61] These considerations include that supervisory authorities for various sectors are confronted with the impact of artificial intelligence (AI) and are required to develop expertise and wish to share knowledge. Further, reference is made to the cross-sectoral topics in relation to AI that require coordination. On the basis of these features, it has been decided to create a new AI supervisor, operating as part of the *Autoriteit Persoonsgegevens*, and constituting a knowledge centre and initiator also for other supervisory authorities in respect of the supervision on AI. In our view, similar circumstances (of cross-sectoral importance of HREDD and CCAPs that require coordination and development of knowledge with different supervisory authorities in any event) apply in respect of future tasks under the Directive. On this basis, we believe that a somewhat similar structure may be considered for the supervisor to be appointed under the Directive, namely the selection of a supervisory authority (*e.g.*, the ACM) as a platform for the cooperation and coordination with other supervisors and agencies that encounter topics in relation to HREDD and CCAPs. It is in any event clear that the supervision under the CSDDD constitutes a very material task, that requires either one or more existing supervisory authorities or a newly incorporated supervisor to build and develop staff and expertise to conduct this task.

3.5 *Substantiated Concerns as Trigger for Enforcement and the Link with the Complaints Procedure*

In this paragraph, we will include our comments on the provisions of Article 19 CSDDD and the concurrence with Article 9 CSDDD. As set out in par. 2, substantiated concerns based on objective circumstances that an in-scope company breaches its obligations in respect of HREDD and the adoption of a CCAP, must be assessed by the supervisor and, where appropriate, must lead to the exercise of their powers. In respect of a failure to act by the supervi-

52 Wet van 24 oktober 2019 houdende de invoering van een zorgplicht ter voorkoming van de levering van goederen en diensten die met behulp van kinderarbeid tot stand zijn gekomen, *Stb.* 2019, 401.

53 *Kamerstukken II* 2015/16, 34506, nr. 2 (Article 2, par. 1), *Voorstel van wet van het lid Van Laar houdende de invoering van een zorgplicht ter voorkoming van de levering van goederen en diensten die met behulp van kinderarbeid tot stand zijn gekomen*.

54 *Kamerstukken II* 2015/16, 34506, nr. 13 (*Tweede nota van wijziging*).

55 *Kamerstukken II* 2015/16, 34506 (*Handelingen, nr. 9*).

56 *Kamerstukken II* 2022/23, 35761, nr. 9 (*Voorstel van wet van de leden Van der Graaf, Jasper van Dijk, Thijssen, Van der Lee, Koekkoek en Hammelburg houdende regels voor gepaste zorgvuldigheid in waardeketens om schending van mensenrechten en het milieu tegen te gaan bij het bedrijven van buitenlandse handel*).

57 *Kamerstukken II* 2022/23, 35761, nr. 9.

58 *Kamerstukken II* 2022/23, 35761, nr. 9.

59 *Kamerstukken II* 2015/16, 26485, nr. 217. In this same debate, an advisory role for the National Contact Point under the OECD Guidelines has been advocated.

60 "Ook spraken MVO Nederland en VNO-NCW zich uit voor een aparte, nieuwe toezichthouder." *Kamerstukken II* 2022/23, 35761, nr. 9.

61 Letter of the Ministerie van Binnenlandse Zaken en Koninkrijksrelaties, ref. 2022-0000689652, dated 22 December 2022.

sor on the basis of the filing of a substantiated concern, there should be court access. We assume that the national implementation of these provisions will provide for the applicability of the provisions of the *Algemene wet bestuursrecht* (Awb) in respect of having a sufficient (legitimate) interest to access the court.[62] This includes that a sufficient interest as set out in Section 1:2, par. 1 or 3 Awb, is required. On the basis of the Awb, court access is warranted, subject to the condition that one is directly affected in its interests[63] in accordance with Section 1:2 Awb. Notably, for legal entities, any general and collective interests which they represent in particular by virtue of their objective (as included in the articles of association) and as evidenced by their actual activities, shall be considered to be their (potentially directly affected) interests.[64] We note that Article 19, par. 5 CSDD includes a reference to the requirement of a '*legitimate interest*' in accordance with national law. We would argue that the threshold as applied on the basis of Section 1:2 Awb would be a suitable implementation in the Netherlands of this legitimate interest-threshold under the Directive. Based on the wording of the Directive, the threshold of legitimate interest as included in Article 19, par. 5 CSDDD, does not necessarily apply to Article 19, par. 4 CSDDD, which provides that the supervisory authority must inform the person filing the substantiated concern of its reasoned assessment thereof. We would argue that a similar threshold has to apply to Article 19, par. 4 CSDDD in accordance with the Awb. As a result, only a person or entity with a direct interest allowing it to seek court access to object to a failure by the supervisor to act, would be entitled to receive a reasoned assessment of the substantiated concern. Again, we believe that the reference as included in Article 19, par. 4 CSDDD, to the relevant provisions of national law, allows for this. Further, as noted in par. 2 by reference to Recital (65), it is expected that in particular staff (employees) of the in-scope company is potentially in a position to file substantiated concerns under Article 19 CSDDD. Notably, the Directive does not require any person, including staff members, to file a complaint on the basis of the complaints procedure that any in-scope company has to adopt on the basis of Article 9 CSDDD, before a substantiated concern can be filed with the supervisor. We would argue that as a general rule, in accordance with the typical approach in whistleblower regulations, a person who files a substantiated concern with a supervisory authority is only admissible under Article 19 CSDDD, if as a first step the internal complaints procedure has been applied. This prevents the concurrence of an internal complaints procedure and an external assessment of a substantiated concern. It also provides the in-scope company with the opportunity to respond to the complaint directly vis-à-vis the person filing the complaint, rather than being immediately confronted with an external assessment. The information from the previous internal complaints procedure will also assist the supervisor in its subsequent assessment, if the response by the company is not satisfactory to the complainant. Finally, we believe it may be useful to implement this two-step approach as the inclusion of a certain barrier for filing the substantiated concerns with the supervisory authority.

4. The Concurrence of Public and Private Enforcement: Conflicts in respect of the Potential for Civil Liability next to Supervisory Enforcement

Next to the system of investigation and enforcement by supervisory authorities, the CSDDD prescribes that national laws must provide for civil liability exposure for damages caused by breaches of Articles 7 and 8 CSDDD.[65] The combined public law and private law enforcement is justified in the Directive by reference to the need to ensure an effective compensation of victims of adverse impacts.[66] According to the Directive, civil law liability should attach to companies for damage caused to a natural or legal person, under the condition that the company intentionally or negligently failed to prevent and mitigate potential adverse impacts or to bring actual impacts to an end and minimise their extent and as a result of such a failure a damage was caused to the natural or legal person.[67, 68] The proposal by the European Commission contains a certain link between regulatory exposure and civil liability.[69] The civil liability regime as proposed by the European Commission has been subject to heavy scrutiny from various Member States. In the Political Compromise it is proposed to significantly amend Article 22 CSDDD such that civil liability effectively only arises when the non-compliance with the Directive amounts to a tortious

62 As is allowed by Article 19, par. 5 CSDDD.
63 This translates into: *een rechtstreeks bij het besluit betrokken belang*.
64 We will not discuss here the impact of a derived interest (*afgeleid belang*) and when this should be considered, as discussed in CRvB 7 November 2018, ECLI:NL:CRVB:2018:3473 and ECLI:NL:CRVB:2018:3474.

65 Notably, this does not cover all provisions that are subject to public supervision and enforcement.
66 Recital (56) CSDDD.
67 Recital (56) CSDDD.
68 For a detailed description of the civil law liability under Article 22 CSDDD, reference is made to L. Lennarts, 'Civil Liability of Companies for Failure to Conduct Corporate Sustainability Due Diligence Throughout Their Value Chains – Is Art. 22 CSDDD Fit for Purpose?', *Ondernemingsrecht* 2023/36.
69 Article 22, par. 2 CSDDD, stipulates that Member States have to 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. This includes a certain safe harbour effect of measures taken on the basis of the Directive as a protection against civil liability. Further, 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 CSDDD, as well as any collaboration with other entities to address adverse impacts in its value chains, must be taken into account for civil liability.

act under the Member States' tort law systems.[70] If this proposal by the Council of the European Union is to be followed, which we would welcome, we do not see any special concerns or attention points when it comes to the concurrence of regulatory and civil law exposure. This is because in that case for civil law exposure to arise, all Dutch law requirements for tortious liability would need to be present. Further, a company cannot be held liable if the damage was caused only by its business partners in its chain of activities.[71] On the basis of the wording in the Political Compromise, we therefore do not see specific attention points in respect of the relation between the regulatory exposure under the Directive and the risk of civil law liability in the event of a tortious act. More specifically, a breach of the obligations of the Dutch implementation of Article 7 or 8 CSDDD (or, as a matter of fact: of any of the provisions of the Directive) by an in-scope entity may be invoked by an injured party as a basis for a breach of laws constituting a basis for an action in tort against the in-scope entity. Whether this will be successful will depend *inter alia* on whether the interests of the injured party form part of the interests that the relevant provision aims to protect. If a breach has been established by the supervisor through the imposition of a fine or otherwise, this may be presented by the injured party as proof of such breach. For the court ruling on the claim for damages, such supervisory antecedent is admissible as evidence and its value is to be weighted by the court.

5. Conclusion

The Directive triggers the need for the appointment of a national competent authority to supervise the HREDD and the CCAP requirements. This will constitute a substantial task which will be challenging for various reasons. These include the novelty of the supervisory tasks on these topics and the position of the Directive within a broad framework of sector-specific regulation, including ESG legislation (including various legislative instruments on transparency and reporting that may overlap or diverge on certain topics depending on the sector involved) and ESG litigation. The envisaged system of public enforcement can only be effectively implemented on the basis of the understanding that the scope of the HREDD and CCAP requirements are clear and predictable for the in-scope entities. Coordination and cooperation between supervisory authorities within each Member State and on a cross-border basis are vital.

70 Article 22, par. 1, of the Political Compromise. Also see item 27 of the introduction to the Political Compromise.
71 Article 22, par. 1, final paragraph, of the Political Compromise.

Tomas Arons & Manuel Lokin[1]

The Corporate Climate Transition Plan: How to Ensure Companies are Paris-Proof

Ondernemingsrecht 2023/35

- **The interaction between CSDDD and CSRD needs to be clarified. If companies are required to adopt a climate plan under CSRD, Article 15 CSDDD has little to no added value.**
- **Denying a review by the supervisory authority under CSDDD leaves private enforcement as the only mechanism available to test whether a company's climate plan is Paris-proof.**
- **Scrutiny of climate plans by national courts based on national legal systems will lead to a lack of harmonisation and an unlevel playing field fostering unequal effects.**

In this contribution, the authors discuss the relevance and effects of Article 15 of the Corporate Sustainability Due Diligence Directive which obliges Member States to ensure that large companies shall adopt a climate transition plan to ensure that the business model and strategy of these companies are compatible with the limiting of global warming to 1.5 °C in line with the Paris Agreement and the objective of achieving climate neutrality by 2050. How does Article 15 relate to the obligations regarding climate plans of the already adopted CSRD? Is climate change an adverse impact under the CSDDD? Should variable executive remuneration be linked to the objectives of a company's climate plan? Will shareholders have a say-on-climate? What role is envisaged for public enforcement by the supervisory authority to ensure the transition to a sustainable economy? And how does the CSDDD affect private enforcement, like cases such as the *Milieudefensie/Shell* case? This contribution is based on the proposal of the European Commission published on 23 February 2022 and the compromise text of the EU Council published on 30 November 2022.

1. Introduction

The Corporate Sustainability and Due Diligence Directive ("CSDDD") aims to promote responsible business conduct. Its twin sister, the Corporate Sustainability Reporting Directive ("CSRD")[2] aims to ensure corporate high-quality reporting on sustainability matters.[3] This includes a requirement for certain companies to report their climate transition plan in the management report. The requirement for having a climate transition plan ("Climate Plan") is laid out in Article 15 CSDDD. In this contribution, we focus on the question of whether the Climate Plan measures to be adopted and implemented by companies under Article 15 CSDDD are of any added value now that the CSRD is adopted, and if so, whether these measures are clear, proportionate, and enforceable.

This contribution is based on the proposal of the European Commission published on 23 February 2022 ("Commission Proposal") and the compromise text of the CSDDD of the European Council published on 30 November 2022 ("Political Compromise").[4] The text of Article 15 of the Commission Proposal and the Political Compromise are:

Text Article 15 (Commission Proposal)

> 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 re-

1 Tomas Arons is professor of Financial Law and Collective Redress at Utrecht University as well as a legal counsel at the association Vereniging van Effectenbezitters and Manuel Lokin is professor of Company Law at Utrecht University as well as lawyer at Stibbe in Amsterdam.

2 Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting [2022] *OJ* L322/15.
Final text adopted can be found in Directive of the European Parliament and of the Council amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting, 2021/0104(COD) PE-CONS 35/22, 16 November 2022.

3 Recital 12 of the preamble to the CSRD.

4 Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 – General Approach, 2022/0051(COD), 15024/22, REV 1, 30 November 2022.

ferred 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.

Text Article 15 (Political Compromise)

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, including implementing actions and related financial and investments plans, 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 and the objective of achieving climate neutrality by 2050 as established in Regulation (EU) 2021/1119, and where relevant, the exposure of the undertaking to coal-, oil- and gas-related activities, as referred to in Articles 19a(2), point (a)(iii), and 29a(2), point (a)(iii), of Directive 2013/34/EU. 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 greenhouse gas emission reduction objectives in its plan.
3. […]

Under the CSDDD regime, companies have to adopt a Climate Plan to ensure that their business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C as agreed in the Paris Agreement[5] and – added by the Political Compromise – the objective of achieving climate neutrality by 2050, and where relevant, the exposure of the undertaking to coal-, oil- and gas-related activities (hereafter: "Paris-proof").[6]

Because CSRD and CSDDD are related, it is important that an alignment of the scope of applications and the provisions is ensured. Paragraph 2 discusses the conditions and scope of application of Article 15 CSDDD and the interaction with CSRD. Paragraph 3 deals with the question of whether climate change qualifies as an actual and potential adverse impact on the environment under the CSDDD and is as such subject to a due diligence obligation and intensive supervision by the designated supervisory authority.

5 Paris Agreement [2016] *OJ* L282/4.
6 Art. 15 CSDDD. See Regulation (EU) 2021/1119 for the objective of achieving climate neutrality by 2050 and see Art. 19a(2), point (a)(iii), and Art. 29a(2), point (a)(iii) of Directive 2013/34/EU for the exposure of the undertaking to coal-, oil- and gas-related activities.

In the Commission Proposal, companies were obliged to duly take into account the fulfilment to be Paris-proof 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.[7] Even though this provision has been deleted in the Political Compromise as a result of strong opposition by Member States,[8] it is optional and maybe recommendable for companies to adopt this link in their remuneration policy. We deal with this question in paragraph 4.

The question is by which means and which parties can enforce companies to comply with this duty and whether the adopted Climate Plan itself is a binding and enforceable obligation. The objective of an adopted Climate Plan should be to ensure that the company's business model and strategy is Paris-proof. Therefore, it is important to address the question of what remedies are available in case an interested party (shareholders, stakeholders, non-governmental general interest institutions) deems a company's Climate Plan incompatible to achieve the goal of the Paris Agreement. For short, which parties have a say-on-climate? The availability of such a mechanism to ensure Paris compatibility is especially important because the CSDDD fails to establish clear emission reduction goals.[9]

The question of whether shareholders (should) have a say-on-climate will be addressed in paragraph 5. Paragraph 6 discusses the public enforcement mechanisms of Article 15 CSDDD. The public enforcement mechanism seems to be limited to situations where companies do not adopt a Climate Plan at all. It is left to Member States to assign this task to a new or existing supervisory authority or authorities. Any scrutiny of Paris-proofness by this supervisory authority seems to be excluded or is at most very limited. Even though CSDDD leaves room for private enforcement by general interest institutions in (collective) proceedings, it does not establish a private enforcement mechanism that is guaranteeing a level playing field for companies regarding their Climate Plan.[10]

7 Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, COM(2022) 71 final (CSDDD Proposal).
8 Letter by the presidency of the European Council attached to Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 – General Approach, 2022/0051(COD), 15024/22, 28 November 2022, par. 26.
9 Cf. critical notes by De Kluiver and De Waard. See H.J. de Kluiver, 'Kroniek van het Ondernemingsrecht, Ondernemingsrecht, mensenrechten en klimaat. Doen we de goede dingen en doen we ze goed? Over moeizame regulering en gebrek aan focus', *NJB* 2022/952, p. 1180-1181 and D. de Waard, 'Concepten en standaarden: Een analyse van de aansluiting van de European Sustainability Reporting Standards op de praktijk van duurzaamheidsverslaggeving', in: M. Luckerath-Rovers et al. (eds.), *Jaarboek Corporate Governance 2022-2023*, Deventer: Wolters Kluwer 2022, p. 139.
10 De Kluiver 2022, p. 1180-1181.

Ever since the *Milieudefensie/Shell* case[11] companies need to be aware that adopted climate plans can be subject to scrutiny by private individuals and organisations via liability claims. The question arises whether these claims fall under the scope of the liability regime of Article 22 CSDDD or whether national rules on civil liability may cover claims in case any interested party deems the Climate Plan insufficient to achieve its goal, *i.e.* ensuring that the company's business model and strategy are Paris-proof. It is noteworthy that the CSDDD does not provide the reliefs available to interested parties in case liability for insufficient Climate Plans can be established. Can interested parties non-governmental general interest institutions like Milieudefensie, Urgenda, and Client Earth[12] still obtain a court order (or declaratory relief) that a company is bound to reduce its emissions further than planned like in the *Milieudefensie/Shell* case? These questions concerning the private enforcement mechanism will be discussed in paragraph 7. In paragraph 8 concluding remarks are given.

2. Climate Plans under the CSDDD and in Relation to the CSRD

One of the CSDDD's ambitions is to ensure by law the transition of companies to a sustainable and Paris-proof business model and strategy. Article 15 CSDDD, however, has been largely stripped out in the Commission Proposal, and even more in the Political Compromise. Despite some companies' expectations, CSDDD does not set any concrete emission reduction goals.[13] It leaves companies ample room to set their emission reduction objectives on their own and even includes the option for some companies to omit greenhouse gas ("GHG") emission reduction objectives in their Climate Plans.[14] Member States are only obliged to ensure that certain large companies adopt a Climate Plan ensuring that its business model and strategy is Paris-proof.[15] This plan needs to contain implementing actions and related financial and investments plans so as to achieve this Paris-proof business model and strategy.[16]

The aforementioned ambition is still reflected in the way the article is written down which assumes a results-oriented approach (the Climate Plan must be Paris-proof) rather than a best-efforts approach.[17] The scope of Article 15 CSDDD (both in the Commission Proposal as in the Political Compromise) is, however, limited to EU companies (formed in accordance with the legislation of a Member State) with more than 500 employees on average and a net worldwide turnover of more than EUR 150 million in the last financial year for which annual financial statements have been or should have been adopted and non-EU companies generating a net turnover of more than EUR 150 million in the EU in the financial year preceding the last financial year ("Large Companies").[18]

Article 15 CSDDD has multiple connections to the CSRD, which is already adopted and introduces the obligation for companies to report in their management report on their Climate Plans including implementing actions and related financial and investment plans.[19] As requested by many Member States, the text of Article 15 CSDDD on combating climate change has been aligned in the Political Compromise as much as possible with the obligation of the CSRD to report a company's Climate Plan, in order to avoid problems with its legal interpretation while avoiding broadening the obligations of companies under Article 15 CSDDD.[20]

At first glance, the CSDDD appears to contain the basic obligation to adopt a Climate Plan and the CSRD appears to contain the obligations to report on it. It is highly questionable, however, whether the CSRD itself already imposes an obligation on companies to adopt a climate plan.[21] While it is true that a slightly more cautious approach may be found in the recitals, the text of the directive itself does not seem to leave any room for companies covered

11 The Hague District Court 26 May 2021, ECLI:NL:RBDHA:2021:5337 (*Milieudefensie/Shell*).

12 Client Earth holds the Board of Directors of Shell liable under the UK Companies Act, s. 172 and 174, for not implementing a climate strategy that is in keeping with the Paris Agreement goal. ClientEarth Press Release 15 March 2022, https://www.clientearth.org/latest/press-office/press/clientearth-starts-legal-action-against-shell-s-board-over-mismanagement-of-climate-risk/.

13 Please note some companies expected the (EU) legislator to adopt a policy framework with clear and binding legislative targets so as to facilitate the transition. Cf. The Hague District Court 26 May 2021, ECLI:NL:RBDHA:2021:5337 (*Milieudefensie/Shell*), par. 2.5.17.

14 Cf. J.E.S. Hamster, 'Het voorstel van de Europese Commissie voor een richtlijn inzake passende zorgvuldigheid op het gebied van duurzaamheid: een kritische verkenning', *MvO* 2022, 5&6, p. 155. It is, however, highly debatable if the possibility to omit GHG emission reduction objectives in Climate Plans, as stems from Art. 15(2) CSDDD, is of much use, as we will explain in this paragraph.

15 Art. 15 includes a reference to the objective of achieving climate neutrality by 2050 as established in the European Climate Law as well. 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') [2021] *OJ* L243/1.

16 This clarification concerning Art. 15 was published by the Presidency of the Council on 25 July 2022 in advance of the meeting on 5 and 6 September of the Working Party on Company Law.

17 See also The European Company Law Expert Group (ECLE), the ECGI-blog, 2 August 2022, see https://ecgi.global/blog/why-article-15-combating-climate-change-should-be-taken-out-csdd.

18 'Large companies' are defined in Art. 2(1)(a) and Art. 2(2)(a) CSDDD.

19 Art. 19a(2), point (a)(iii), and Art. 29a(2), point (a)(iii) Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups [2014] *OJ* L330/1) as replaced by Art. 1(4) and (7) CSRD.

20 Letter by the presidency of the European Council attached to Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 – General Approach, 2022/0051(COD), 15024/22, REV 1, 30 November 2022, par. 25. See Art. 19a(2), point (a)(iii), and Art. 29a(2), point (a)(iii) Directive 2013/34/EU as replaced by Art. 1(4) and (7) CSRD.

21 See the article of L.K. van Dijk & J.B.S. Hijink (in Dutch) who argue that such an obligation already stems from the CSRD. L.K. van Dijk & J.B.S. Hijink, 'Finalisering van de Europese CSRD: een mijlpaal voor duurzaamheidsverslaggeving met grote impact op het ondernemingsrecht vanaf 2025', *Ondernemingsrecht* 2022/87, par. 2.2.4.

by the directive not to adopt a Climate Plan.[22] Should the CSRD indeed itself contain an implicit obligation for companies to adopt a Climate Plan, Article 15(1) CSDDD seems largely redundant.

The same applies to Article 15(2) CSDDD which provides that the company has to identify, on the basis of information reasonably available to the company, the extent to which climate change is a risk for, or has an impact on, the company's operations.[23] 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 GHG emission reduction objectives in its plan.[24]

The draft European Sustainability Reporting Standard (ESRS) E1 – Climate Change ("ESRS E1") – yet to be adopted by the European Commission – elaborates on the obligation of CSRD for companies to report their Climate Plans by setting standards for these Climate Plans.[25] A "transition plan to mitigate climate change" is defined in ESRS E1 as "an aspect of the undertaking's overall strategy that lays out the entity's targets and actions for its transition towards a lower-carbon economy, including actions such as reducing its GHG emissions and with the objective of limiting climate change to 1.5 °C and climate neutrality."[26] The (draft) ESRS E1 seems to leave no room for companies that fall within the scope of CSRD whether to include GHG emission reduction objectives in their report. The Application Requirements,[27] for example, state: "Sectoral pathways have not yet been defined by the public policies for all sectors. Hence, the disclosure under paragraph 15(a) on the compatibility of the transition plan with the objective of limiting global warming to 1.5 °C should be understood as the disclosure of the undertaking's GHG emissions reduction target. The disclosure under paragraph 15(a) shall be benchmarked in relation to a pathway to 1.5 °C. This benchmark should be based on either the sectoral decarbonisation methodology if available for the undertaking's sector or the absolute contraction methodology bearing in mind its limitations (i.e., it is a simple translation of emission reduction objectives from the State to Corporate level)." Since this part of ESRS E1 qualifies as material, making this standard is always applicable when a company is required to adopt a Climate Plan, emission reduction objectives must be included in a company's Climate Plan. Should the ESRS E1 be adopted in its current form, Article 15(2) also seems largely redundant.

It should be noted that there is a difference in the scope of application of Article 15 CSDDD and the CSRD.[28] If CSRD itself contains an obligation to adopt a Climate Plan, then this obligation will apply to a significantly larger number of companies.[29] Furthermore, while the vast majority of companies covered by the CSDDD will also be covered by the CSRD, a few may not. Only in those cases where a company is covered by the CSDDD but not by CSRD and ESRS E1 would Article 15(1) and (2) CSDDD still have some utility.

In addition, the inclusion of Article 15 in the CSDDD ensures that certain rights granted to the supervisory authority under the CSDDD also cover Climate Plan of Large Companies. However, as we will argue later, these rights of the supervisory authority with respect to Article 15 in the Political Compromise have been curtailed to the point where these rights have become negligible. Furthermore, it is logical that the designated supervisory authority that must supervise compliance with Article 15 CSDDD is the same as the supervisory authority that supervises compliance with companies' reporting obligations. Assuming an implicit obligation that follows from CSRD to adopt a Climate Plan, the supervisory authority that must supervise compliance with the obligations that follow from CSRD will have much more far-reaching powers. It can therefore be concluded that, if it is indeed to be assumed that the CSRD already imposes an obligation on such companies to adopt a Climate Plan, and should ESRS E1 be adopted in its current form by the European Commission, Article 15 CSDDD has little or no added value. We would therefore argue that the interaction between CSDDD and CSRD needs to be clarified before Article 15 CSDDD is adopted.

3. Is Climate Change an Actual and Potential Adverse Impact on the Environment?

Under Article 6 CSDDD, companies are required to take appropriate measures to identify actual and potential adverse impacts on human rights and the environment arising "from their own operations or those of their subsidiar-

22 See recital 30 of the preamble to the CSRD in which the words "any plans they may have" are included, translated in Dutch as "eventuele plannen", in German as "etwaige Pläne" and in French as "les éventuels plans qu'elles peuvent avoir". Recital 30: "[…] They should also be required to disclose any plans they may have to ensure that their business model and strategy are compatible with the transition to a sustainable economy and with the objectives of limiting global warming to 1,5 °C in line with the Paris Agreement and achieving climate neutrality by 2050, as established in Regulation (EU) 2021/1119, with no or limited overshoot."
23 See also recital 50 of the preamble to the CSDDD.
24 Art. 15(2) CSDDD.
25 The ESRS E1 refer more specifically to a transition plan to mitigate climate change, which seems to be the same as the plan referred to in Art. 15 CSDDD. In the following, we will continue to refer to a *climate plan* when we refer to the plan referred to in Art. 15 CSDDD. To be retrieved from https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FED_ESRS_E1.pdf.
26 See draft ESRS E1, Appendix A.
27 See draft ESRS E1, Appendix B.
28 Large undertakings, and small and medium-sized undertakings, except micro undertakings, which are public-interest entities as defined in point (a) of point (1) of Art. 2 of Directive 2013/34/EU and third-country undertakings which generate a net turnover of more than EUR 150 million in the Union for each of the last two consecutive financial years and which have a subsidiary undertaking or a branch on the territory of the Union that meets certain thresholds. See Art. 1(3) and Art. 40a Directive 2013/34/EU as replaced by Art. 1(1) and Art. 1(14) CSRD.
29 CSRD will apply to around 50,000 companies while the CSDDD will apply to around 13,000 EU companies and 4,000 non-EU companies.

ies and, where related to their value[30] chains of activities, those of their business partners".[31] Surprisingly, climate change as such does not fall under the definition of adverse impact on the environment as adopted in the CSDDD. The Paris Agreement or any other legislation with clear emission reduction goals are not listed in Annex I, part II of the CSDDD. This list enacts the legal prohibitions and obligations that may serve as a basis to conclude an adverse environmental impact.[32]

It is interesting to note that the Administrative tribunal of Paris in its judgments of 3 February 2021[33] and of 14 October 2021[34] categorises climate change as such environmental damage. The recently[35] adopted Article 1246-1247 of the French Civil Code explicitly mentions environmental damage[36] as a compensable loss under French civil law. It is therefore remarkable that such an explicit qualification is not found in the CSDDD.

Due to CSDDD's overarching purpose, it seems even more strange that climate change does not qualify as an adverse impact. The reason it is not explicitly inserted in Annex I, Part II could be that, if climate change were defined as an adverse impact, far-reaching due diligence obligations would apply to a broader set of companies, including mapping the impact of business partners on climate change as well. Not defining climate change as an adverse impact, however, does not mean that due diligence obligations due to climate change will not have to be performed in certain cases. For example, Annex I, Part II states the obligation to avoid or minimise adverse impacts on wetlands.[37] The Wadden region in the Netherlands, which played an important role in the *Shell* case, is one of the wetlands that is recognised as such under the Ramsar Convention.[38] Couldn't the argument be made that a contribution to climate change leads to an adverse impact on wetlands, such as the Wadden region, and thus that climate change indirectly still qualifies as an adverse impact? In that context, it also cannot be ruled out that climate change can be indirectly classified as having an adverse impact on human rights. If so, there is a possible risk of overlap between the Climate Plan on the one hand and the prevention action plan or corrective action plan on the other that the company should develop and implement.[39] More so, it gives the designated supervisory authority in that case far more powers to intervene than this supervisory authority appears to be entitled to with respect to supervising the Climate Plan (see paragraph 6). We note that Article 15 has no added value in this regard since in this case combating climate change is addressed through Article 6 et seq. CSDDD.

4. **Remuneration**

Article 15(3) of the Commission Proposal states that 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. Due to the strong concerns of Member States regarding the provision proposed by the Commission linking the variable remuneration of directors to their contribution to the company's business strategy and long-term interest and sustainability, Article 15(3) has been deleted from the Political Compromise. The argument for deletion is that the form and structure of directors' remuneration are matters primarily falling within the competence of the company and its relevant bodies or shareholders. Delegations called for not interfering with different corporate governance systems within the Union, which reflect different Member States' views about the roles of companies and their bodies in determining the remuneration of directors.[40]

This argument is remarkable in the sense that, with regards to the revised Shareholders Rights Directive ("SRD

30 In adjusting the change from value chains to chains of activities, the word value still seems to be here incorrectly.

31 Art. 1(1)(a) CSDDD indicates that adverse impacts are related to human rights and the environment.

32 Art. 3(b) CSDDD: 'adverse environmental impact' means an impact on the environment resulting from violation of one of the prohibitions and obligations listed in the Annex I, Part II. Cf. D. Horeman, 'Aansprakelijkheid en duurzaamheid in de financiële sector', in: M.J. van Lopik & I.P. Palm-Steyerberg (eds), *The Twin Transition: Digital & Sustainable Finance (Bundel ter gelegenheid van het dertigjarig bestaan van de Vereniging voor Financieel Recht) (Serie Van der Heijden Instituut nr. 179)*, Deventer: Wolters Kluwer 2022, p. 403.

33 Tribunal administratif Paris (TA Paris), 3 févr. 2021, "Association OXFAM France et autres", req. n° 190467, 190468, 190472, 190476/4-1), r.o. 16 http://paris.tribunal-administratif.fr/content/download/179360/1759761/version/1/file/1904967190496819049721904976.pdf.

34 Tribunal administratif Paris (TA Paris), "Association OXFAM France et autres", req. n° 190467, 190468, 190472, 190476/4-1), par. 11: 'Le préjudice écologique né d'un surplus d'émissions de gaz à effet de serre présente un caractère continu et cumulatif dès lors que le non-respect constaté du premier budget carbone a engendré des émissions supplémentaires de gaz à effet de serre, qui s'ajouteront aux précédentes et produiront des effets pendant toute la durée de vie de ces gaz dans l'atmosphère, soit environ 100 ans. Par conséquent, les mesures ordonnées par le juge dans le cadre de ses pouvoirs d'injonction doivent intervenir dans un délai suffisamment bref pour permettre, lorsque cela est possible, la réparation du préjudice ainsi que pour prévenir ou faire cesser le dommage constaté.' (underlining TA and ML)
http://paris.tribunal-administratif.fr/content/download/184990/1788790/version/1/file/1904967BIS.pdf.

35 Loi n° 2016-1087 du 8 août 2016 pour la reconquête de la biodiversité, de la nature et des paysages, *JORF* n° 0184 du 9 août 2016.

36 '*Préjudice écologique*'.

37 "[A]s defined in Article 1 of the Convention on Wetlands of International Importance especially as Waterfowl Habitat of 2 February 1971 (Ramsar Convention), interpreted in line with Article 4(1) of the Ramsar Convention and applicable law in the relevant jurisdiction."

38 See for a map of the wetlands in the Netherlands that qualifies as such under the Ramsar Convention:
https://www.nationaalgeoregister.nl/geonetwork/srv/api/records/07d73b60-dfd6-4c54-9c82-9fac70c6c48e.

39 See Art. 7(2)(a) and Art. 8(3)(b) CSDDD for the obligation to develop and implement, without undue delay, a prevention action plan resp. a corrective action plan.

40 See Political Compromise, p. 9.

II"),[41] interfering to some extent with different corporate governance systems within the Union was not perceived as insurmountable. A seemingly contradictory argument against Article 15(3), therefore, was the potential overlap with the obligations that apply based on SRD II.[42] SRD II already states that the remuneration policy should contribute to the business strategy, long-term interests and sustainability of the company and should not be linked entirely or mainly to short-term objectives. Directors' performance should be assessed using both financial and non-financial performance criteria, including, where appropriate, environmental, social and governance ("ESG") factors.[43] SRD II, therefore, demands that the remuneration policy shall contribute to the company's business strategy and long-term interests and sustainability and shall explain how it does so.[44]

It should be noted that the scope of SRD II and CSDDD differs, namely applying to listed companies respectively to Large Companies. Accordingly, the obligation contained in Article 15(3) CSDDD was limited to companies that had linked variable remuneration to the contribution of a director to the company's business strategy and long-term interests and sustainability. This largely eliminated the difference in scope, covering only those companies that fall within the scope of SRD II and those companies that voluntarily linked variable remuneration to the contribution of a director to the company's business strategy and long-term interests and sustainability.

It should be noted, that the obligation that follows from SRD II is broader and covers all components that can be subsumed under ESG. Article 15(3) only addresses the link between variable remuneration and climate change mitigation and GHG emission reduction, and therefore only made explicit one aspect of ESG-related remuneration to be included under SRD II. Thus, the removal of this provision does not cause great grief, as this obligation already seems to follow from SRD II. Whether all companies in scope are entirely aware of this SRD II duty is another matter. Despite the deletion of this explicit requirement in CSDDD, it therefore seems preferable for companies to explicitly explain how the remuneration policy and individual variable remuneration are linked and contribute to achieving the goals of the company's Climate Plan, as integrated into the company's business model and strategy. The same applies to companies that are not covered by SRD II but have adopted Climate Plans. It seems inconceivable that, although a company adopts a Climate Plan and implements this Climate Plan by integrating it into the company's business model and strategy, the variable remuneration is in no way linked to the climate goals the company seeks to achieve.

5. Corporate Governance – Say on Climate

The CSDDD Commission Proposal lacked a specification of the role of shareholders or the general meeting in the corporate sustainability and due diligence obligations. The draft report of the European Parliament's Committee on Legal Affairs provided for shareholder involvement in a company's Climate Plan.[45] 'That plan shall be developed in consultation with stakeholders, and the plan and its implementation shall be approved by the company's shareholders, where applicable.'[46] The latter provision seems to refer to national (company) law to determine whether the Climate Plan and its implementation is subject to shareholders' (general meeting) approval. Furthermore, it leaves it to national legislation to determine whether shareholders have the power to pass a binding resolution in a general meeting concerning the company's corporate sustainability and due diligence obligations and its Climate Plan.[47] The CSRD does not require Member States to provide such powers either. So it is left for Member States to determine whether shareholders in a general meeting need to give their approval or may introduce a draft resolution concerning the Climate Plan.

A mandatory approval by the general meeting of the Climate Plan is deemed to be contrary to Dutch company law's tenet of board autonomy.[48] However, De Jongh recommends that the general meeting may review the actual execution of the Climate Plan in their annual meeting. This could result in a resolution expressing a non-binding opinion on the Climate Plan reporting in the management report.[49] Van Olffen & Breukink conclude that on the basis of Dutch case law, the management board is not obliged to consult the general meeting on its Climate Plan or to allow a non-binding vote on the execution of the Climate Plan.[50] However, shareholders may discuss based on their general right to ask questions, the (execution of the) Climate Plan.[51] If shareholders are not given the opportunity to vote on the Climate Plan, there is a chance that shareholders will use other votes to express any dissatisfaction with the Climate

41 Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement [2017] *OJ* L132/1.
42 The European Company Law Expert Group (ECLE), the ECGI-blog, 2 August 2022, see https://ecgi.global/blog/why-article-15-combating-climate-change-should-be-taken-out-csdd.
43 See recital 29 of the preamble to SRD II.
44 See Art. 9a(6) SRD II.
45 Draft report on the proposal for a directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 (COM(2022)0071 – C9-0050/2022 – 2022/0051(COD)) Committee on Legal Affairs, 7 November 2022.
46 Amendment 166 to Art. 15(1) CSDDD.
47 For an overview of shareholder activism on sustainability, we refer to M.H.C. Bakker, 'Aandeelhoudersvoorstellen en duurzaamheid: een verkenning', *Ondernemingsrecht* 2022/38.
48 J.M. de Jongh, 'Say on climate', *Ondernemingsrecht* 2021/110, par. 6.
49 De Jongh 2021, par. 6. De Jongh expresses that ideally this matter would be regulated in the Shareholder Rights Directive.
50 M. van Olffen & E.J. Breukink, 'Say on what's next?', *Ondernemingsrecht* 2022/17, par. 4.
51 Van Olffen & Breukink 2022, par. 6.

Plan, for example their binding vote on adopting the remuneration policy and their non-binding vote on the remuneration report.[52] Increasingly, executive remuneration is expected to be linked in part to non-financial objectives of the company. This also increases the likelihood that a negative vote can be expected in the event that the variable remuneration of directors is insufficiently linked to achieving the goals of the Climate Plan and in the event that the company's ambitions as evidenced by the Climate Plan are deemed insufficient.[53] Another potential protest vote can be expected when reappointing the person who holds sustainability in his or her portfolio. The absence of a direct say-on-climate may therefore lead to indirect forms of say-on-climate.

6. Public Enforcement

Each Member State has to designate one or more supervisory authorities to supervise compliance with the obligations enshrined in Articles 6 to 11 and Article 15 CSDDD.[54] The connecting factor is like in most EU company and financial law legislation, the registered office of the company.[55] The designated authority of the Member State where the company's registered office is situated is the competent supervisory authority.

In principle, Member States are free in their choice which supervisory authority they designate. Member States may designate the authorities for the supervision of regulated financial undertakings also as supervisory authorities for the purposes of the CSDDD.[56] In case the public supervisory task is divided over multiple authorities, the Member State has to ensure that the respective competencies of those authorities are clearly defined and that they cooperate closely and effectively with each other.[57]

In the Bill brought before the Dutch Parliament on 2 November 2022 with a similar scope as the CSDDD, the initiating MPs have designated the Netherlands Authority for Consumers and Markets (ACM).[58] The ratio is found in the general task of the ACM to ensure a well-functioning market of citizens and companies. In this market, companies compete fairly and consumers are protected from unfair practices. Therefore ACM is the guardian of these rules ensuring fair play.[59]

However, we deem the Netherlands Authority for the Financial Markets (AFM) better suited for this supervisory task concerning companies' Climate Plans. The AFM is already the designated authority for companies' non-financial reporting duties.[60] As the Climate Plan will become part of the sustainability reporting requirements in the management report with the entering into force of the CSRD, it is envisaged that AFM will be the designated supervisor as well.[61] A substantial argument in this regard is the fact that these duties are essentially about adopting a Climate Plan including emission reduction objectives that are communicated by the company to the world outside in their non-financial reporting.[62]

The CSDDD provides that Member States have to 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 Articles 6 to 11 and Article 15.[63] A major limitation in relation to Article 15 of the Political Compromise, however, is that Article 18 of the Political Compromise provides that Member States shall only require supervisory authorities to supervise that companies have adopted a Climate Plan.[64] The reason this limitation is added may be found in the criticism of the far-reaching power that the supervisory authority otherwise seemed to have over the content of Climate Plans. The fear is that Article 15 CSDDD allows and even requires direct governmental intervention in a company's Climate Plan. "By setting the emission reductions in lieu of the company, the supervisory authority effectively dictates the business model and strategy of that company. This legislative strategy seems to overestimate governmental wisdom while underestimating the judgement of those

52 Cf. on 21 February 2023 AllianzGI announced it will hold directors accountable if the company does not have net zero targets in place and a credible strategy for how to achieve them. As of 2024, depending on the set-up of the board AllianzGI will vote against the Chairperson of the Sustainability Committee, the Strategy Committee or the Chairperson of the Board of certain high-emitting companies if the net zero ambitions or the Climate-related Financial Disclosures are deemed dissatisfactory. https://www.allianzgi.com/en/press-centre/media/press-releases/20230221-proxy-voting-release.

53 Cf. on 21 February 2023 AllianzGI announced as of 2023 it strengthens its voting guidelines with respect to sustainability aspects; it expect European large-cap companies to include environmental, social and governance key performance indicators into their remuneration and would vote against pay policies if this is not implemented. https://www.allianzgi.com/en/press-centre/media/press-releases/20230221-proxy-voting-release.

54 Art. 17(1) CSDDD.

55 Art. 17(2) CSDDD.

56 Art. 17(5) CSDDD.

57 Art. 17(4) CSDDD.

58 Art. 1:1 sub q Voorstel Wet verantwoord en duurzaam internationaal ondernemen, *Kamerstukken II* 2022/23, 35761, No. 9.

59 *Kamerstukken II* 2022/23, 35761, No. 10, p. 25.

60 Art. 2 up and including Art. 4 Financial Reporting Supervisory Act (Wtfv).

61 See the Dutch legislative proposal, "Wijziging van Boek 2 van het Burgerlijk wetboek tot implementatie van Richtlijn (EU) 2021/2101", *Kamerstukken II* 2021/22, 36157, No. 2.

62 The AFM is already the supervisor concerning non-financial reporting and it is envisaged that its task will be extended by CSRD implementing sustainability reporting requirements. See the Dutch legislative proposal, "Wijziging van Boek 2 van het Burgerlijk wetboek tot implementatie van Richtlijn (EU) 2021/2101" *Kamerstukken II* 2021/22, 36157, No. 2. Cf. https://www.afm.nl/nl-nl/sector/themas/duurzaamheid/csrd.

63 Art. 18(1) CSDDD.

64 Art. 18(1) last sentence CSDDD.

who were elected to run the company."[65] This criticism is a bit heavy-handed. The fact that a supervisory authority may review whether a presented Climate Plan is sufficiently compatible with the objectives as stated in Article 15 CSDDD does not automatically mean that the supervisory authority, if it finds the plan insufficiently compatible, then also dictates the specific content of the Climate Plan that is Paris-proof, including setting specific targets for every individual element of the Climate Plan, and thus dictates the company's business model and strategy. The supervisory authority will need to approach a Climate Plan holistically. It seems more reasonable to expect that the supervisory authority will merely delineates the outer boundaries of such a plan. Nevertheless, the fact that a supervisory authority can reject a Climate Plan, and take possible action, does of course mean that the supervisory authority has some indirect influence on the outer limits of the strategy and business model of companies that fall within the scope. But isn't that the very reason for this directive, to set those outer limits to create a level playing field? And what is the alternative? That it is up to national courts to decide on Climate Plans and GHG emission reduction on a case-by-case basis?

The chosen compromise seems to drastically limit the powers of the supervisory authority to the extent that the supervisory authority may only examine whether a Climate Plan has been adopted. The question is how Article 15 CSDDD's result-oriented approach relates to the supervisory authority's obligation to determine that a company has indeed adopted a Climate Plan. An in-depth analysis of whether the presented Climate Plan is indeed Paris-proof does not seem to be within the powers of the supervising authority based on the Political Compromise. But does this mean that the supervisory authority may not review the content of that plan at all? Shouldn't the supervisory authority at least marginally test whether the adopted plan qualifies as a Climate Plan within the meaning of Article 15 CSDDD? We would say, for example, that the supervisory authority should at least review whether the plan contains the various components that should be reflected in a Climate Plan, including a rationale for why, according to the company, the Climate Plan is Paris-proof. In addition, the question arises as to how these limited powers of the supervisory authority under CSDDD relate to the powers vested in the supervisory authority under CSRD.

The aforementioned limitation in the Political Compromise to the review of the content of a Climate Plan also colours the other powers of the supervisory authority under CSDDD. A supervisory authority shall have the power to request information and carry out investigations related to compliance with the obligations set out in Article 15 CSDDD. Furthermore, a supervisory authority may initiate an investigation on its own motion or as a result of substantiated concerns communicated to it in accordance with Article 19 CSDDD, where it considers that it has sufficient information indicating a possible breach by a company of its CSDDD obligations.[66] Article 19 CSDDD entitles any natural and legal persons to submit substantiated concerns to the competent[67] 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.[68]

From a practical standpoint, it seems logical for a supervisory authority not to vet every Climate Plan, but only to test them marginally as described before. But how does the result-oriented obligation to have a Paris-proof Climate Plan relate to the powers of the supervisory authority if there are substantiated concerns? Does the provision in the Political Compromise that supervisory authorities are only required to supervise that companies have adopted a Climate Plan mean that these substantiated concerns may only relate to the absence of a plan that can be qualified as a Climate Plan on the bases of Article 15 CSDDD? It looks like that, but comes across as contrived. The same seems to apply to the powers the designated supervisory authority at least needs to have, according to Article 18(5) CSDDD, being: (a) to issue an order, (b) to impose penalties as provided in Article 20 CSDDD, and (c) to impose interim measures in case of urgency due to the risk of severe and irreparable harm.[69] The orders that may be imposed are: (i) the cessation of infringements (thus, ordering a company to adopt a climate plan?); (ii) the abstention from any repetition of the relevant conduct (thus, ordering the company to continue having such a plan?); and (iii) where appropriate, to provide remediation proportionate to the infringement and necessary to bring it to an end.[70]

It is questionable whether it is so beneficial for companies to deny the supervisory authority a more substantive review of Climate Plans. The Network of Supervisory Authorities can lead to a harmonised approach by supervisory authorities within the EU, and an approved Climate Plan by the supervisory authority could give companies some comfort when tested in court. Leaving aside the rights enjoyed by the supervisory authority under CSRD,

65 The European Company Law Expert Group (ECLE), the ECGI-blog, 2 August 2022, see https://ecgi.global/blog/why-article-15-combating-climate-change-should-be-taken-out-csdd.

66 Art. 18(2) CSDDD.

67 The wording of Art. 19(1) CSDDD states 'any supervisory authority', but a logic interpretation is that these interested parties must submit their substantiated concerns to the competent supervisory authority (i.e. the supervisory authority of the Member State where the company's statutory seat is situated). Otherwise, supervisory authorities which are not competent, should refer these substantiated concerns to the competent supervisory authority. This would put too much of an administrative burden on these supervisory authorities.

68 Art. 19(1) CSDDD.

69 Art. 18(5) CSDDD.

70 Art. 18(5) CSDDD.

denying a more substantive review by the supervisory authority under CSDDD leaves the option of private enforcement as the only mechanism available to test whether the Climate Plan of a company is indeed Paris-proof. We would like to stress the point that courts addressed by actors with a valid claim have to deliver justice in the sense that the court has to set the minimum requirements for companies if their actual Climate Plans are ruled to infringe upon the rights of (represented) claimants. In this way, the courts may set intermediate emission reduction goals like in the *Shell* case if there is a proven doubt that the Climate Plans are Paris-proof indeed. Unlike the competent supervisory authority, the courts do not have any discretionary authority on whether to take action; courts are bound to deliver justice within the boundaries set by the applicable law to claimants in case their rights are infringed. Scrutiny of Climate Plans by national courts based on national legal systems, therefore, bears an enormous risk of a lack of harmonisation regarding the liability for Paris-incompatible Climate Plans, forcing courts to set GHG emission reduction objectives and effectively dictating the business model and strategy of certain companies. It will most probably lead to an unlevel playing field and is bound to have unequal effects, hitting the company that gets sued while sparing others in comparable situations.[71] Furthermore, the legal remedies available to different actors, including collective redress options for claimants or (representative) organisations differ widely within the EU.[72] This phenomenon increases the unequal effects.

7. Private Enforcement

How can interested parties bring about the required compatibility of these implementing actions and related financial and investment plans with the transition to a sustainable economy? Under Dutch law, private parties may be sued by another private party in a general interest collective redress action under Article 3:305a of the Dutch Civil Code. The *Milieudefensie/Shell* case is a prime example of this.[73]

The Hague District Court has ordered Royal Dutch Shell (RDS) to reduce the CO_2 emissions of the Shell group by net 45% in 2030, compared to 2019 levels, through the Shell group's corporate policy.[74] However, the Court emphasises that it does not formulate a legally binding standard for – in this case – a reduction pathway to be chosen.[75] It is important to reiterate that a climate plan is not static, but a dynamic constantly updated living document. The Court does not prescribe a particular climate plan; it merely delineates the outer boundaries of such a plan. RDS's obligation is derived from the unwritten standard of care from the applicable Book 6 Section 162 Dutch Civil Code as interpreted by the District Court on the basis of the relevant facts and circumstances, the best available science on dangerous climate change and how to manage it, and the widespread international consensus that human rights offer protection against the impacts of dangerous climate change and that companies must respect human rights.[76] The assessment culminates in the conclusion that RDS is obliged to reduce the CO_2 emissions of the Shell group's activities by net 45% at end 2030 relative to 2019 through the Shell group's corporate policy. This reduction obligation relates to the Shell group's entire energy portfolio and to the aggregate volume of all emissions (scopes 1 through 3). It is up to RDS to design the reduction obligation, taking into account its current obligations and other relevant circumstances. The reduction obligation is an obligation of result for the activities of the Shell group (scope 1), with respect to which RDS may be expected to ensure that the CO_2 emissions of the Shell group are reduced to this level. Furthermore, the reduction obligation is a significant best-efforts obligation with respect to the business relations of the Shell group, including the end-users (scopes 2 and 3), in which context RDS may be expected to take the necessary steps to remove or prevent the serious risks ensuing from the CO_2 emissions generated by the business relations, and to use its influence to limit any lasting consequences as much as possible. This obligation is also designated hereinafter as 'RDS' reduction obligation'.[77]

The Court has not yet concluded a violation of RDS's obligation. However, the court has established that RDS may violate its reduction obligation, and the claimed order to comply with that obligation must be allowed. The claimed order may only be rejected if Milieudefensie et al. had no interest, to be respected at law, in it. This could occur when the order cannot contribute to preventing the alleged imminent infringement of interests. RDS' argument that the order will not be effective and possibly be counter-produc-

71 This last argument was also used against a substantive review by the supervisory authority. See The European Company Law Expert Group (ECLE), the ECGI-blog, 2 August 2022, see https://ecgi.global/blog/why-article-15-combating-climate-change-should-be-taken-out-csdd: "In view of the limited governmental resources and the enforcement specificities of each Member State, governmental interventions are bound to have unequal effects, hitting one company while sparing others in comparable situations – and this does not even take into account that not all the companies are covered by the Directive, even if they are major polluters."

72 Cf. findings of Common Core research on mass harm, edited by Rianka Rijnhout & Tomas Arons, to be published in first 6 months of 2023 with Intersentia.

73 Cf. R.J.B. Schutgens & J.J.J. Sillen, 'Algemeenbelangacties bij de burgerlijke rechter' in: Vereniging voor de vergelijkende studie in Nederland en België, Preadviezen 2020-2021, *De algemeenbelangactie en de civiele rechter*, Den Haag: Boom Juridisch, p. 178.

74 The Hague District Court 26 May 2021, ECLI:NL:RBDHA:2021:5337 (*Milieudefensie/Shell*).

75 The Hague District Court 26 May 2021, ECLI:NL:RBDHA:2021:5337 (*Milieudefensie/Shell*), par. 4.4.29.

76 The Hague District Court 26 May 2021, ECLI:NL:RBDHA:2021:5337 (*Milieudefensie/Shell*), par. 4.1.3.

77 The Hague District Court 26 May 2021, ECLI:NL:RBDHA:2021:5337 (*Milieudefensie/Shell*), par. 4.1.4.

tive fails on the basis of the considerations[78] regarding the effectiveness of the reduction obligation. Since it has been established that in every scenario climate change as a result of CO_2 emissions-induced global warming has negative consequences for the Netherlands and the Wadden region, with serious human rights risks for Dutch residents and the inhabitants of the Wadden region, Milieudefensie has an interest in allowing its claimed order.[79]

It is important to note that in this *Shell* case, in essence the court ordered Shell to adjust its climate transition plan and bring its activities and policies in line with the court-ordered emission reduction goals. In Article 15 CSDDD the so-called *Shell*-norm is (partially) codified.[80] Therefore, the result of adopting Article 15 CSDDD is that it can no longer be disputed that large companies have a legal duty to adopt a Climate Plan that is Paris-proof.[81] Although any review or critical assessment of the Paris-compatibility of a company's Climate Plan via public enforcement seems to be excluded, this does not exclude per se litigating the Paris-compatibility of a company's Climate Plan via private enforcement.

Article 22 CSDDD contains a specific civil liability regime. It has been amended significantly in the Political Compromise in order to achieve legal clarity and certainty for companies and to avoid unreasonable interference with the Member States' tort law systems.[82] The four conditions that have to be met in order for a company to be held liable – a damage caused to a natural or legal person, a breach of the duty, the causal link between the damage and the breach of the duty and a fault (intention or negligence) – were clarified in the text and the element of fault was included.[83]

Please note that the CSDDD does not provide for civil liability in case a company does not comply with its Article 15 obligation to set up and implement a Climate Plan and adopt emission reduction objectives. Article 22 CSDDD only provides for a civil liability regime in case of a violation of its duty to adopt appropriate measures to prevent potential (Article 7) and bring to an end actual (Article 8) adverse impact on human rights and the environment. As we noted before, although climate change as such has not been explicitly recognised as a potential or actual adverse impact on the environment, climate change could still indirectly fall under the definition of adverse impact on the environment and could therefore, via Article 7 and 8, fall within the scope of Article 22 CSDDD.

It is important to note that the civil liability rules under the CSDDD are not without prejudice to EU 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 the CSDDD.[84] So this provision leaves room for legal systems like the Dutch in the *Shell* case, to bring emission reduction duties under its liability regime in the *Shell* case via potential violations of human rights.

However, this lack of harmonisation regarding the liability for Paris-incompatible climate plans means companies are confronted with an unlevel playing field. The EU legislator risks companies to transfer their seats and activities so as to escape cumbersome liability regimes (forum shopping).

8. Concluding Remarks

The main question that needs answering is whether the CSRD does contain its own requirement for companies to adopt a Climate Plan. If that is indeed the case, then Article 15(1) CSDDD has little to no added value. This is all the more true for Article 15(2) CSDD as the restriction contained therein seems to be negated by the – yet to be adopted by the European Commission – ESRS E1. As a result, only in those exceptional cases where a company is covered by the CSDDD but not by CSRD and ESRS E1, Article 15(1) and (2) CSDDD will still have some utility. If CSRD does not contain its own requirement to adopt a Climate Plan, then the introduction of Article 15(1) is necessary to create a legal obligation to do so. Furthermore, the inclusion of Article 15 in the CSDDD could have some utility due to the supervision rights of the supervisory authority under the CSDDD. However, now that these rights have been curtailed in the Political Compromise to the point where these rights have become negligible, the supervision of Climate Plans under CSDDD also seems to have no real added value anymore. If supervision regarding Climate Plans will play a role, it will be because the supervisory authority under CSRD is exercising its powers. We would therefore argue that the interaction between CSDDD and CSRD needs to be clarified before CSDDD is adopted.

78 The Court refers here to See the 2013 memorandum of the PBL Netherlands Environmental Assessment Agency and the KNMI memorandum '*De achtergrond van het klimaatprobleem*' ('The background of the climate problem'). Footnote 11 of the Court ruling.

79 The Hague District Court 26 May 2021, ECLI:NL:RBDHA:2021:5337 (*Milieudefensie/Shell*), par. 4.5.5.

80 Cf. S.B. Garcia Nelen, 'De beursvennootschap van de toekomst', *O&F* 2022/2, p. 13.

81 Cf. The Hague District Court 26 May 2021, ECLI:NL:RBDHA:2021:5337 (*Milieudefensie/Shell*), par. 4.1.2: '*RDS endorses the need to tackle climate change by achieving the goals of the Paris Agreement and reducing global CO_2 emissions. According to RDS, the energy transition required for achieving these goals demands a concerted effort of society as whole. RDS opposes the allowance of the claims: RDS asserts that there is no legal basis for doing so. RDS also argues that the solution should not be provided by a court, but by the legislator and politics.*'

82 Letter by the presidency of the European Council attached to Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 – General Approach, 2022/0051(COD), 15024/22, 28 November 2022, par. 26.

83 Letter by the presidency of the European Council attached to Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 – General Approach, 2022/0051(COD), 15024/22, REV 1, 30 November 2022, par. 27.

84 Art. 22(4) CSDDD.

It is further noteworthy that climate change as such is not defined as an adverse impact under CSDDD. However, this does not alter the fact that climate change may indeed play an indirect role with respect to the due diligence obligations based on Article 6 through 11.

In the Political Compromise, the provision to link variable remuneration to the objectives of a company's Climate Plan has been deleted. The removal of Article 15(3) will not cause great grief, as this obligation already seems to follow from SRD II. Despite the deletion of this explicit requirement in CSDDD, it therefore seems preferable for listed companies to explicitly explain how the remuneration policy and individual variable remuneration are linked and contribute to achieving the goals of the company's Climate Plan, as integrated into the company's business model and strategy. The same applies to companies that are not covered by SRD II but have adopted Climate Plans.

A major limitation under the Political Compromise is that supervisory authorities under CSDDD may only supervise that companies have adopted a Climate Plan. This limitation drastically colours the powers of the supervisory authority under CSDDD. It is questionable whether it is so beneficial for companies to deny the supervisory authority a more substantive review of Climate Plans. Leaving aside the rights enjoyed by the supervisory authority under CSRD, denying a more substantive review by the supervisory authority under CSDDD leaves the option of private enforcement as the only mechanism available to test whether the Climate Plan of a company is indeed Paris-proof. Please note in this respect, that the CSDDD does not provide for civil liability in case a company does not comply with its Article 15 obligation to set up and implement a Climate Plan and adopt emission reduction objectives. The civil liability rules under the CSDDD are, however, not without prejudice to EU 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 the CSDDD. Therefore, CSDDD leaves room for legal systems, like the Dutch in de *Shell* case, to bring emission reduction duties under its liability regime via potential violations of environmental and human rights. Article 15 CSDDD (partially) codifies the so-called *Shell*-norm, making it no longer possible to dispute that a company has a duty to implement a Climate Plan that is Paris-proof. This makes it a little easier to have Climate Plans tested by a court. Scrutiny of Climate Plans by national courts based on national legal systems, however, bears an enormous risk of a lack of harmonisation regarding the liability for Paris-incompatible climate plans, and will most probably lead to an unlevel playing field fostering unequal effects. This accomplishes exactly what companies and Member States would like to avoid by introducing legislation that applies within the EU.

Loes Lennarts[1]

Civil Liability of Companies for Failure to Conduct Corporate Sustainability Due Diligence throughout their Value Chains – Is Art. 22 CSDDD Fit for Purpose?

Ondernemingsrecht 2023/36

- **The current focus of the proposed CSDDD on (partly) harmonising substantive law should be shifted to harmonising crucial procedural and practical obstacles that may prevent access to remedy (sections 2.7 and 4).**
- **The European legislature should not embark upon a mission impossible to harmonise – with the aim of achieving a level playing field and legal certainty – the requirements that must be met for a company to be held civilly liable for violating its CSDD duties in the Directive. This is better left to further development in national courts (sections 2.2, 2.3, 2.5, 2.6, 3 and 4).**
- **Art. 22(5) Commission Proposal does not really ensure access to remedy and may lead to legal uncertainty. Therefore, it is suggested to strike Art. 22(5) and to provide for a special conflicts rule giving claimants the option to found their claim on the law of the country where the defendant in-scope company is domiciled (sections 2.7 and 4).**

This article discusses Art. 22 of the Corporate Sustainability Due Diligence Directive (CSDDD) as proposed by the Commission on 23 February 2022 (Commission Proposal). This provision aims to ensure effective compensation of victims for violation of the CSDD obligations laid down in the Commission Proposal by partly harmonising Member States' rules on the civil liability of companies for damages arising from such violations. The aim of this article is to determine to what extent Art. 22 Commission Proposal fulfils the purposes of ensuring effective compensation of victims – including access to remedy – as well as legal certainty and a level playing field. The most important amendments to Art. 22 Commission Proposal suggested by the Rapporteur of the EP, as well as the key changes proposed in the Council's Political Compromise are included in the analysis. The conclusion of this article is that Art. 22 Commission Proposal is not fit for the purposes it aims to achieve. Some suggestions are made that may – to some extent – remedy this.

1. Introduction

The EU Commission's proposal for a Corporate Sustainability Due Diligence Directive (hereafter: Commission Proposal) specifically aims to increase corporate accountability for adverse impacts on human rights and the environment and to improve access to remedies for those affected by such adverse impacts.[2] It does so by codifying duties for large[3] companies to perform corporate sustainability due diligence throughout their value chains and by providing for instruments that may be used to achieve compliance and help to ensure access to remedy for victims. This article discusses private enforcement by means of civil liability claims brought by (or on behalf of) victims. This is the subject of Art. 22 Commission Proposal, which aims to ensure effective compensation of victims for violation of the obligations laid down in Art. 7 and 8 Commission Proposal.[4] To this end, it partly harmonises Member States' rules on the civil liability of companies for damages arising from such violations.

As noted in the Explanatory Memorandum to the Commission Proposal, a number of companies have already been brought before Member States' courts for causing or failing to prevent adverse impacts at the level of their subsidiaries or value chains. At present, cases are decided based on differing civil liability regimes. Such divergent national liability regimes may lead to distortions of competition in the internal market[5] and to legal uncertainty for both companies and victims of adverse impacts. The Commission Proposal aims to prevent distortions of competition and to create legal certainty for companies and stakeholders as regards expected behaviour and liability,[6] by clarifying 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. Art. 22 Commission Proposal further aims to improve access to remedy by ensuring the application of the harmonised civil liability rules also in cases where

1 Loes Lennarts holds the chair in Comparative Company Law at the University of Groningen.

2 Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, Brussels 23 February 2022, 2022/0051 (COD) (hereafter: Commission Proposal), p. 3.
3 For a discussion of the companies that fall within the scope of the Commission's Proposal, I refer to the contributions to this issue by Anne Lafarre, *Ondernemingsrecht* 2023/33 respectively Davine Roessingh, Hylke ten Bruggecate, Lisanne Baks & Sven Dumoulin, *Ondernemingsrecht* 2023/39.
4 See recital 56 of the Preamble to the Commission Proposal.
5 Commission Proposal, p. 12.
6 Commission Proposal, p. 3.

otherwise the law applicable to a civil liability claim is not the law of a Member State. According to the Explanatory Memorandum, the civil liability regime proposed in Art. 22 Commission Proposal is essential to ensure the necessary level playing field.[7]

In this contribution, I will analyse Art. 22 Commission Proposal, in order to determine to what extent it fulfils the purposes of ensuring effective compensation of victims – including access to remedy – as well as legal certainty and a level playing field. In section 2 of this contribution, the content of Art. 22 of the Commission Proposal is discussed. In section 3, I will briefly discuss the most important amendments proposed in the draft report prepared by the Rapporteur of the EP,[8] as well as the key changes to Art. 22 Commission Proposal proposed in the Political Compromise that was published on 30 November 2022.[9] In Section 4, I will conclude that Art. 22 of the Commission Proposal is not fit for the purposes it aims to achieve and make some suggestions that may – at least to some extent – remedy this.

2. Art. 22 Commission Proposal

2.1 *Main Structure of the Provision and the Policy behind it*

According to Art. 22(1)(a) Commission Proposal, companies falling within the scope of the CSDDD (in-scope companies) can be made liable for damages if they failed to comply with the obligation laid down in Art. 7 Commission Proposal, to take appropriate measures to prevent or adequately mitigate potential adverse environmental and human rights impacts that should have been identified pursuant to Art. 6 Commission Proposal, and the obligation laid down in Art. 8 Commission Proposal, to take appropriate measures to bring actual adverse impacts to an end or minimise them. Companies will be liable if, as a result of such failure, an adverse impact occurred and led to damage (Art. 22(1)(b)). Adverse environmental and human impacts are defined in Art. 3(b) and (c) as adverse impacts resulting from violations of prohibitions and obligations pursuant to the international environmental conventions listed in Part II of the Annex to the Proposal, respectively the rights or prohibitions listed in Part I Section 1 of the Annex, as enshrined in the international conventions listed in Part I Section 2 of the Annex.

Pursuant to Art. 1 Commission Proposal, the obligation to perform corporate sustainability due diligence (CSDD) is limited to the company's own operations, those of its subsidiaries and those of *established* business relationships. Consequently, civil liability pursuant to Art. 22 Commission Proposal will not arise in respect of adverse impact resulting from the operations of value chain partners with whom the company does *not* have an established business relationship. Established business relationships are partners with which a company expects to have a lasting relationship, in view of its intensity or duration and which do not represent a negligible or merely ancillary part of the company's value chain.[10] According to the Explanatory Memorandum, the proportionality requirement is the motive for limiting the scope of the required CSDD (and liability for failure to perform it) to the group and established business relationships within its value chain. It would lead to excessive litigation if companies could be held liable for adverse impacts resulting from the operations of all partners in the value chain.[11] The same motive led to the adoption in Art. 22(2) Commission Proposal of a defence that may be available to the company, in the event of damage caused by an adverse impact resulting from the activities of an indirect business partner qualifying as an established business relationship. In this case, the company shall not be liable 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.

The drafters of Art. 22 Commission Proposal acknowledged, that rules designating the applicable liability law could prevent Art. 22 Commission Proposal from achieving its aim of ensuring effective compensation for victims of adverse impacts. Pursuant to Art. 4 Rome II Regulation (hereafter: Rome II),[12] a competent Member State's court in the home state of the company may very well have to apply the law of a third country, being the host state, where the damage occurred (*lex locus damni*).[13] This third country's law may not provide for a CSDD liability of companies in the top tier of the value chain that is equivalent to the liability provided for in the CSDDD. This may mean that victims do not obtain the compensation they seek. To ensure access to remedy,[14] Art. 22(5) Commission Proposal provides that the liability provided for[15] in provisions of national law is of overriding mandatory application in cases where the law applicable to claims to that effect is not the law of a Member State.

7 Commission Proposal, p. 12.
8 https://www.europarl.europa.eu/doceo/document/JURI-PR-738450_EN.pdf.
9 https://data.consilium.europa.eu/doc/document/ST-15024-2022-REV-1/en/pdf.

10 Art. 3(f) CSDDD.
11 Explanatory Memorandum, p. 17.
12 Regulation (EC) No 864 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations.
13 There are exceptions to Art. 4 Rome II, the most important of which in the context of the CSDDd is Art. 7 Rome II, which, in case of environmental damage, allows the claimant to base his claim on the law of the country in which the event giving rise to the damage occurred.
14 Recital 61 of the Preamble.
15 As noted by Rui Dias, 'CSDDD and PIL: Some Remarks on the Directive Proposal', 2 June 2022, https://conflictoflaws.net/2022/csdd-and-pil-some-remarks-on-the-directive-proposal/, this seems to be poor drafting. What is meant here is not the liability itself, but the provisions of national law implementing Art. 22 CSDDD.

A final remark on the policy behind Art. 22 Commission Proposal is that this provision only provides for partial harmonisation and seems to allow – at least to a certain extent – stricter provisions of national law, no matter that the importance of achieving a level playing field is mentioned several times in the Explanatory Memorandum.[16] As to partial harmonisation: several important issues that may arise in civil claims brought on the basis of provisions implementing Art. 22 Commission Proposal will necessarily be governed by national law, simply because Art. 22 Commission Proposal does not regulate these issues in any way. Some of these issues will be addressed below, in sections 2.4, 2.5 and 2.7. As to minimum harmonisation: Art. 22(4) Commission Proposal provides that the civil liability rules under this Directive shall be without prejudice to 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. The question as to which extent this allows Member States to go beyond the rules that must be implemented pursuant to Art. 22 CSDDD will be addressed in section 2.6.

2.2 *The Duty to perform CSDD and the Remedy of Civil Liability: Natural Partners?*

As explained above, the scope of the obligation for in-scope companies to perform CSDD in their value chains does not extend to partners that do not qualify as established business relationships. The reason for this limitation of the duty to perform CSDD is, that the Proposal's drafters chose to link the remedy of civil liability to – in principle – *any* failure to perform the due diligence required by Art. 7 and 8 of the Commission Proposal throughout the value chain. This called for limitation of the scope of the business partners to be included in CSDD, in order to prevent the risk of excessive litigation.[17] The policy choice to carve out from the duty to perform CSDD those partners which do not qualify as established business relationships can – and has been – criticised.[18] I agree with the criticism: the Commission Proposal takes the wrong approach by limiting the duty to perform CSDD to certain partners in the value chain based on the nature of the relationship with these partners. The correct approach is the one taken in UNGP 17 and 18:[19] CSDD should be risk-based, for the very reason that the more severe risks may often be present in the lower tiers of the value chain.[20] Severity of the risk and the likelihood of the risk materialising should be decisive for the duty to exercise CSDD, without discriminating between different types of business relationships.[21] Companies should identify – and, where necessary, prioritise[22] – risks throughout their *entire* value chain and develop a plan to address potential adverse impacts that are inherent to these risks. This does *not* mean that they should always be liable if they fail to perform adequate due diligence throughout the value chain. Liability should depend on all circumstances of the case, including the extent to which the company has actually caused or contributed to the adverse impact and the extent of the company's leverage in addressing the adverse impact.[23]

Although liability should not be an automatic effect of a violation of CSDD duties under the Commission Proposal, obliging in-scope companies to exercise CSDD will undoubtedly enhance these companies' legal responsibility. For these companies, *not* having a CSDD policy will no longer be an option.[24] In the absence of a binding obligation to have a CSDD policy, these companies could try to avoid responsibility – and liability – by applying an 'ostrich policy' to CSDD. This kind of behaviour will be illegal if the CSDD duties in the Commission Proposal are codified. In-scope companies will have to take stock of the human rights and environmental risks within their value chains. To illustrate this: an in-scope company with subsidiaries and business partners involved in the exploration and production of oil will have to assess the risks to the environment and human rights that are inherent in these activities. If necessary, the in-scope company must address potential and actual adverse impacts by taking appropriate measures. It can safely be assumed that, pursuant to Art. 6 Commission Proposal, the human rights and environmental risks involved in oil exploration and production will have to be identified, when the in-scope company's chain of activities involves the exploration and production of oil in a po-

16 See p. 3 (two mentions), p. 7, p. 11, p. 13 (three mentions) and p. 18 Explanatory Memorandum.

17 See footnote 11.

18 C.C. van Dam, 'Verantwoordelijkheid en aansprakelijkheid voor leveranciers en afnemers', *NTBR* 2022/45, p. 392; Shift, 'The EU Commission's Proposal for a Corporate Sustainability Due Diligence Directive – Shift's Analysis, March 2022, https://shiftproject.org/resource/eu-csdd-proposal/shifts-analysis/, p. 4-5; Christopher Patz, 'The EU's Draft Corporate Sustainability Due Diligence Directive: A First Assessment, *Business and Human Rights Journal* (2022), p. 2 and 7.

19 UN Office of the High Commissioner for Human Rights, 'UN Guiding Principles on Business and Human Rights, Implementing the United Nations "Protect, Respect and Remedy" Framework', 2011, https://digitallibrary.un.org/record/720245?ln=en.

20 Shift, *op. cit.*, p. 4. The Dutch government takes the same view, see the file prepared by BNC (the working group that assesses new EU Commission proposals), *Kamerstukken II* 2021/22, 22112, nr. 3393, p. 5-6.

21 European Coalition for Corporate Justice (ECCJ), 'European Commission's proposal for a directive on Corporate Sustainability Due Diligence – A comprehensive analysis', 5 April 2022, https://corporatejustice.org/publications/analysis-of-eu-draft-directive-on-due-diligence/, p. 10.

22 See UNGP 24. See also the BNC file, *Kamerstukken II* 2021/22, 22112, nr. 3393, p. 5-6. It is unfortunate that the Commission Proposal does not sufficiently reflect that in-scope companies may prioritise risks. The Political Compromise proposes to introduce an Art. 6a CSDDD, which clarifies that risks may be prioritised.

23 I refer to UNGP 19, according to which the appropriate action to be taken based on the findings of impact assessments will vary according to 1) whether the business enterprise causes or contributes to an adverse impact, or whether it is involved solely because the impact is directly linked to its operations, products or services by a business relationship; 2) the extent of its leverage in addressing the adverse impact.

24 J.M. de Jongh, 'Beperkte aansprakelijkheid van aandeelhouders', *RMThemis* 2022, p. 307; M.L. Lennarts, 'Moeders, let op uw dochters! Over multinationals en human rights due diligence', *MvO* 2021, p. 165.

litically and/or socially unstable country. It will certainly not be an option for the in-scope company to plead ignorance of the risk of adverse impact on human rights and the environment, if the unstable situation has in the past led to frequent sabotage of pipelines, resulting in oil spills, with serious consequences for the environment and the living conditions of citizens. Pursuant to Art. 7(2)(a) Commission Proposal, the company will – inter alia – have to develop a prevention action plan and take measures to ensure compliance with this plan pursuant to Art. 7(2)b). Art. 7(2)(c) further obliges in-scope companies to make necessary investments, into – inter alia – management or production processes and infrastructures, in order to comply with the obligation to take appropriate measures to prevent or mitigate adverse impact. To what extent this means that the in-scope company can be expected to invest in a leakage detection system to be installed on a pipeline operated several tiers down the group is not clear from the Commission Proposal.[25] But what does seem clear is that the in-scope company will have something to explain in court, if it is sued for any new spills that occurred and were not prevented because no leakage detection system was installed. The in-scope company should not automatically be held to have committed a tort by violating a duty of care owed to the victims. This should depend on all circumstances of the case, such as which measures the in-scope company actually took to ensure that the problem of leakage due to sabotage was addressed and the leverage that the in-scope company had to achieve that these measures be put into effect.

2.3 *What to Think of Art. 22(2) Commission Proposal?*

Some have noted that the possibility provided by Art. 22(2) Commission Proposal, to rely on contractual cascading and verification of compliance in respect of indirect business partners, will only encourage companies to adopt a 'tick-the-box' attitude towards due diligence.[26] Others take a different view.[27] I tend to take the side of those who believe that it will not be so easy to rely on the defence by pointing at contractual assurances and measures implemented to verify compliance. All will depend on the interpretation of whether it was 'unreasonable', given the circumstances, to expect that the contractual assurances sought and the verification of compliance carried out would be adequate. It can be expected that this will be the subject of litigation, if Art. 22(2) is adopted in the form proposed by the Commission, even if, as has been suggested,[28] more clarity is provided on adequate contractual approaches by additional Articles in the Directive or in the guidance of the Commission to be provided pursuant to Art. 12 Commission Proposal. It can be expected that courts across the EU may take different views of when a contractual approach is reasonably adequate and when it is not. In this respect, it would be helpful to create a database of cases litigated on the basis of national provisions implementing Art. 22. In my opinion such a database should be created in any event, also if Art. 22(2) Commission Proposal is not adopted in its current form – or if it is struck, while the core due diligence obligations of Art. 7 and 8 are retained. It is likely that any version of Art. 22 CSDDD that may ultimately be adopted will leave many issues to national law. It is equally likely that the version that may ultimately be adopted will contain important elements that are subject to interpretation by the national courts. Even if Art. 22 is struck from the version that is ultimately adopted, alleged violations of Art. 7 and 8 CSDDD will undoubtedly give rise to civil litigation based on national tort law. Therefore, a database of cases, created and maintained by the EU could be helpful in achieving a measure of uniformity in the application of the legislation implementing the CSDDD. It can also be of assistance to companies affected by the CSDDD and their counsel and by victims of adverse impacts and their counsel.

Art. 22(2) Commission Proposal also provides that, in the assessment of the existence and extent of liability "under this paragraph", due account must be taken of the company's efforts to comply with any remedial action required by a supervisory authority, any investments made and any targeted support pursuant to Art. 7 and 8 CSDDD, as well as any collaboration with other entities to address adverse impacts in its value chains. Because reference is made to "this paragraph" and not to "this Article", it seems that the circumstances mentioned are not to be taken into account in the assessment of the existence and extent of liability for damage caused by subsidiaries or direct business partners, but this is not entirely clear. Another question that arises, is how the circumstances mentioned can play a role in determining the *existence* of a liability or its *extent*. It seems to me that the mentioned circumstances cannot be relied upon by the company as an exoneration from liability, if it has violated Art. 7 and 8 Commission Proposal.

25 See Karsten Sørensen, 'Corporate Sustainability Due Diligence in Groups of Companies', *ECL* 2022, p. 125, who writes that it is not stipulated where the company should invest, but that there is nothing that prevent an interpretation that also includes investment in subsidiaries. This is a matter that deserves to be clarified.

26 Alessio Pacces, 'Supply chain liability in the Corporate Sustainability Due Diligence Directive Proposal', 12 April 2022, https://ecgi.global/blog/supply-chain-liability-corporate-sustainability-due-diligence-directive-proposal; Anne Lafarre, 'Mandatory Corporate Sustainability in Europe: The Way Forward', 21 April 2022, https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/mandatory-corporate-sustainability-due-diligence-europe-way-forward.

27 J.E.S. Hamster, 'Het voorstel van de Europese Commissie voor een richtlijn inzake passende zorgvuldigheid op het gebied van duurzaamheid: een kritische verkenning', *MvO* 2022/5&6, p. 157; S.F. ter Brake, 'Het voorstel voor de richtlijn Corporate Sustainability Due Diligence', *TvOB* 2002-3, p. 82; Nicky Touw, 'Civil liability in the EU proposal for a Corporate Sustainability Due Diligence Directive: a leap forward or stifling progress?', 22 March 2022, https://rethinkingslic.org/blog/tort-law/117-nicky-touw; S. Brabant a.o., The Draft Directive on Corporate Sustainability Due Diligence, Verfassungsblog 16 March 2022, https://verfassungsblog.de/enforcing-due-diligence-obligations/.

28 M.W. Scheltema, 'The Proliferation of Contractual Assurances in Environmental and Human Rights Due Diligence in Supply Chains', *Tijdschrift voor Compliance* 2022, nr. 4, p. 182.

From a Dutch point of view, it seems that these circumstances can only play a role to the extent that they have limited the damage.[29]

2.4 *Burden of Proof?*

Art. 22 Commission Proposal does not contain any provision with the purpose of alleviating the claimant's burden of proof. In particular, it does not regulate who should prove that the company's action was reasonably adequate in the circumstances of the case. This matter is left to national law.[30] The claimant may, depending on the applicable national law, carry the full burden of proving that:

1) an in-scope company has or should have identified a potential adverse human rights impact (Art. 6 Commission Proposal); and that
2) the company did not take the appropriate measures that it should have taken to prevent, adequately mitigate or bring to an end adverse human rights and environmental impacts that have been, or should have been identified (Art. 7 and 8 Commission Proposal); and that
3) there is a causal link between the violation of Art. 7 and 8 and the occurrence of an adverse impact; and that
4) the adverse impact led to damage.[31]

When proving the first two elements, in a case where the damage was caused by a business partner in the value chain, the claimant is faced with the fact that the company's obligations under Art. 6, 7 and 8 Commission Proposal only concern those business partners with whom it has an *established* business relationship. This means that the claimant will not succeed in proving a violation of the CSDD obligations under the Directive, if a risk has materialised through the activities of a business partner with which there is no established relationship, even if this risk is very serious and inherent in the activities carried out by this partner. It may be difficult for a claimant to prove that a partner qualifies as an established business relationship, if the risk materialised as a result of the business operations of a partner in a lower tier of the value chain, as will often be the case. For this reason, the restriction of the due diligence duties to established business relationships can be questioned.[32]

Another hurdle that the claimant may encounter is the burden of proving that the company did not take *appropriate* measures. The main obligations in the Commission Proposal are 'obligations of means'. Companies are not required to guarantee in all circumstances that adverse impacts will never occur or that they will be stopped. The company should take the appropriate measures which can reasonably be expected in the circumstances of the specific case. These include 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.[33] Evidence in respect of these circumstances may not always be easy to obtain for claimants. It may for example be difficult for claimants to prove that the company had leverage to implement certain measures down the value chain. Although the Proposal provides some guidance in the form of a 'toolbox' of possible measures, it will still be open to debate whether the measures taken in a given case were appropriate.[34]

In the event that the company relies on the defence provided by Art. 22(2) Commission Proposal, the burden of proving that the contractual assurances sought and the verification of compliance were inadequate may also rest on the claimant, depending on the applicable national law. This burden may be too heavy for the claimant. Therefore, Member States may choose to include alleviations of the burden of proof in the legislation implementing Art. 22 CSDDD. This may lead to disparities in national laws, causing companies to resort to regulatory arbitrage by relocating to a member State that has not alleviated the claimant's burden of proof.[35] Failing to legislate on the burden of proof, therefore, seems to be a "fatal mistake" of the Commission Proposal, as Pacces writes.[36]

However, it needs careful consideration by the European legislature that alleviation of the burden of proof for the claimant may cause the burden for the defendant company to become too heavy. At least two factors must be taken into account in consideration.

The first one is that the Annex to the CSDDD encompasses a wide array of adverse human rights and environmental impacts that are subject to CSDD under the Directive. Part I (1) of the Annex contains a list of rights and prohibitions included in human rights agreements. Many are clear enough to have a horizontal effect, such as the right of freedom of

29 Cf. C.C. van Dam, 'Verantwoordelijkheid en aansprakelijkheid voor leveranciers en afnemers', *NTBR* 2022/45, p. 391 and M.W. Scheltema, 'Bestuursrechtelijk toezicht op corporate sustainability due diligence', *NTBR* 2022/44, p. 383. For German criticism of the possibility of exoneration for or mitigation of liability on the grounds of *ex post* efforts to offer remedies and willingness to cooperate with national authorities, see: Leonhard Hübner, Victor Habrich & Marc-Philippe Weller, 'Corporate Sustainability Due Diligence – Der EU-Richtlinienentwurf für eine Lieferkettenregelung', *NZG* 2022, p. 649.
30 Recital 58 of the Preamble.
31 This will be discussed in section 2.4.
32 Claire Methven O'Brien & Olga Martin-Ortega, 'Sustainable corporate governance: 'Submission to Consultation on European Commission's proposal for a Directive on corporate sustainability due diligence COM(2022)71 final'', 25 May 2022, www.reseachgate.net, p. 9.
33 See Art. 3(q) Commission Proposal and Recitals 15 and 29 of the Preamble.
34 J.E.S. Hamster, 'Het voorstel van de Europese Commissie voor een richtlijn inzake passende zorgvuldigheid op het gebied van duurzaamheid: een kritische verkenning', *MvO* 2022/5&6, p. 154.
35 S.F. ter Brake, 'Het voorstel voor de richtlijn Corporate Sustainability Due Diligence', *TvOB* 2002-3, p. 83; Alessio Pacces, 'Supply chain liability in the Corporate Sustainability Due Diligence Directive Proposal', 12 April 2022, https://ecgi.global/blog/supply-chain-liability-corporate-sustainability-due-diligence-directive-proposal.
36 See previous footnote.

association, organisation and collective bargaining and the prohibition of child labour.[37] But the list also includes references to legal standards that have been developed entirely with a view to be implemented by states, thus insufficiently clarifying how a private actor is to implement such standard.[38] Examples are the prohibition of withholding an adequate living wage and the violation of the right to enjoy just and favourable conditions of work including a fair wage, a decent living, safe and healthy working conditions and a reasonable limitation of working hours in accordance with Art. 7 of the International Covenant on Economic, Social and Cultural Rights. Moreover, Part I (1) of the Annex also contains a catch-all clause:

> "Violation of a prohibition or right not covered by points 1 to 20 above but included in the human rights agreements listed in Section 2 of this Part, which directly impairs a legal interest protected in those agreements, 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 obligations referred to in Article 4 of this Directive and taking into account all relevant circumstances of their operations, such as the sector and operational context."

This clause has been criticised for not containing rigorous criteria allowing for a substantive differentiation between specifically defined prohibitions and undefined rights.[39] The problem of giving horizontal effect to rights and prohibitions that have been drafted with a view to further implementation by states is even more apparent in Part II of the Annex, which lists a large number of "internationally recognised objectives" and prohibitions included in environmental conventions. An example: the list contains a reference to the Biosphere Treaty, which mainly obliges states to take measures to prevent loss of biodiversity, without specifying what these measures should look like.[40, 41]

A second factor to be taken into account is that much criticism has been levelled at current practices of implementing CSDD by contractual cascading and verification of compliance for not being very effective.[42] This leaves companies in doubt as to which means of fulfilling their CSDD duty throughout their value chains qualify as appropriate measures.

Having regard to the two factors mentioned above, the conclusion seems to be that both i) the extent of the risks that are subject to mandatory due diligence under the CSDDD and ii) what constitutes best practice to ensure compliance with the company's codes of conduct by business partners[43] should be clarified before the burden of proving that adequate measures were taken can be shifted to the company.
On a final note: a strategy that claimants may adopt to tackle the obstacle of proving a violation of Art. 7 and 8 CSDDD is to initiate civil proceedings only after the supervisory authority has established that a company has violated Art. 7 and 8 CSDDD.[44]

2.5 *Causation of Damage?*

Art. 22(1)(b) Commission Proposal provides that companies are liable, if, as a result of a failure to comply with Art.

37 J.S. Hamster, 'Het voorstel van de Europese Commissie voor een richtlijn inzake passende zorgvuldigheid op het gebied van duurzaamheid: een kritische verkenning', *MvO* 2022/5&6, p. 155.

38 Jonas Hein, 'The Vocal, yet Elusive Elephant in the Room of Supply Chain Regulation', *Völkerrechtsblog*, 20 December 2022, doi.org/10.17176/20221220-121448-0, p. 3.

39 See Jonas Hein, *loc. cit*.

40 J.S. Hamster, 'Het voorstel van de Europese Commissie voor een richtlijn inzake passende zorgvuldigheid op het gebied van duurzaamheid: een kritische verkenning', *MvO* 2022/5&6, p. 155 and J.S. Hamster, 'Biodiversiteit & business – een verkenning', *Onderneming en Financiering* 2022, p. 51.

41 Another problem inherent in giving horizontal effect to provisions in international public law instruments is inherent in the extraterritorial effect that this will have through contractual cascading throughout the global value chain. This problem arises when a business partner in a state that has not ratified – for example – an ILO convention has to give contractual assurance that it will respect a the right of freedom of association enshrined in this convention. In this case, the assurance given may conflict with the national law that the business partner will have to comply with, which may place certain restrictions on the freedom of association. This issue has received attention in Germany, in the context of the recently introduced Lieferkettengesetz. See Patricia Wiater, 'Unternehmerische Menschenrechtsbindung nach Maßgabe des Lieferkettengesetzes', *JZ* 2022, p. 866.

42 See Patz, *op. cit.*, at p. 6, referring to the case of Kik, which had a code of conduct in its contract with the Karachi supplier factor, which had been audited as compliant only weeks before a fire broke out in the factory, killing 259 workers. See also the recent report 'Subcontracting; exploitation by design' by Silvia Borelli (commissioned by The Left in the European Parliament), https://media.business-humanrights.org/media/documents/Subcontracting-exploitation-by-design-EN.pdf.

43 See Karl Hofstetter, From 'Corporate Social Responsibility' to 'Corporate Social Liability'?, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4262345, par. 2 a: "Strict liability combined with a compliance defense could be an option, if the standard required only the operation of a specifically defined best practice compliance system. In this case, company groups and their parents would be in the relatively best position to document its proper implementation. From an efficiency perspective, the burden of proof for having fulfilled the duty of care could in this case efficiently be shifted to the company."

44 M.W. Scheltema, 'Bestuursrechtelijk toezicht op corporate sustainability due diligence', *NTBR* 2022/44, p. 384. See also the contribution to this issue by Menno Baks & Kitty Lieverse, *Ondernemingsrecht* 2023/34.

7 and 8, an adverse impact *occurred and led to* damage. Art. 22 Commission Proposal, therefore, does not seem to cover proceedings where the claimant seeks an injunction when damage resulting from an adverse impact is *imminent*, which would mean that this is left to national law. In my opinion, this is an omission, as injunctions can be very effective in achieving that an adverse impact on human rights or the environment is prevented or mitigated.[45]

Although it is clear from Art. 22 Commission Proposal, that a company can only be liable for damage caused by an adverse impact that occurred because the company failed to fulfil its due diligence duties, the matter of how causation is to be determined is left to the national laws of Member States. As a consequence of this, it is not clear which rules apply when several tortfeasors are liable for the same damage caused by an adverse impact. Art. 22(3) Commission Proposal merely provides that the civil liability of a company arising under the Proposal shall be without prejudice to the civil liability of its subsidiaries or of any direct and indirect business partners in the value chain, but leaves unanswered whether this may lead to joint and several liabilities. From a Dutch point of view, joint and several liability seems inherent in the system of the Commission Proposal, which creates a secondary liability for companies that fail to perform their due diligence duties under the Proposal. Primary liability will rest upon the entity/entities that actually violated the human rights and environmental standards listed in the Annex of the Commission Proposal.[46] Pursuant to Art. 6:102 DCC, the company that failed to perform due diligence and the entity/entities that caused the adverse impact will be jointly and severally liable for the full amount of the damage.[47] It can take recourse for the compensation paid to the victims against the primary tortfeasor pursuant to Art. 6:10 DCC. Different rules may apply in other Member States.[48]

Member States' laws also differ in respect of the burden of proving causation. In particular, there will be differences in respect of the situations that may give rise to an alleviation of the burden of proving causation for the claimant.[49] It will remain to be seen to what extent courts will be willing to assume causation if it has been established that the company (clearly) violated its obligations under Art. 7 and 8 CSDDD and a serious risk (that should clearly have been identified pursuant to Art. 6 CSDDD) materialised.

2.6 *What Role is Left for National Law?*

Art. 22(4) Commission Proposal provides that the civil liability rules under the proposed Directive shall be without prejudice to 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. This provision is ambivalent. First, it is not clear what is meant by situations "not covered" by the Directive.[50] Second, it is not clear what is meant by national rules providing for stricter liability. This is not restricted to *pre-existing* stricter provisions and therefore is not aligned with Art. 1(2) Commission Proposal, which provides: "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 the Directive*." When Art. 22(4) is read in conjunction with Art. 1(2) of the Proposal, it seems that *existing* stricter national laws should be respected. This leaves the question unanswered to what extent Member States may go beyond Art. 22 when they create *new* implementing legislation. I believe that it is important that the European legislature clarifies the amount of discretion that Member States have in implementing Art. 22.
Regardless of the amount of discretion that Member States may or may not have when implementing Art. 22, the role of national law will be considerable because many important issues are not addressed in Art. 22. The consequences that this may have for access to remedy for victims in third countries will be discussed in the next section.

2.7 *Does Art. 22(5) Commission Proposal Serve the Purpose of Ensuring Access to Remedy?*

The drafters of the Commission Proposal acknowledged the potential lack of access to remedy due to the fact that the competent court may, pursuant to Art. 4 Rome II, have to apply the law of the non-EU state where the damage occurred. Therefore, pursuant to Art. 22(5) Commission

45 European Coalition for Corporate Justice (ECCJ), 'European Commission's proposal for a directive on Corporate Sustainability Due Diligence – A comprehensive analysis', 5 April 2022, https://corporatejustice.org/publications/analysis-of-eu-draft-directive-on-due-diligence/, p. 20. This is not the place to discuss this in detail, but I note that on the basis of Art. 3:296 DCC, a Dutch court can issue an order to prevent a future breach of a duty of care under tort law.

46 See J.E.S. Hamster, 'Het voorstel van de Europese Commissie voor een richtlijn inzake passende zorgvuldigheid op het gebied van duurzaamheid: een kritische verkenning', *MvO* 2022/5&6, p. 157.

47 See S.F. ter Brake, 'Het voorstel voor de richtlijn Corporate Sustainability Due Diligence', *TvOB* 2002-3, p. 83.

48 See J.E.S. Hamster, *loc. cit.*

49 In this context, the question may arise which law applies to the allocation of the burden of proof. From a Dutch conflicts of law perspective, a distinction must be made between procedural and substantive aspects of the law of evidence in civil proceedings, see Art. 10:3 DCC. It seems clear that statutory assumptions, leading to a reversal of the burden of proof, are governed by the lex causae. It is less clear, though, which conflicts rule designates the law applicable to the question of when the court may, on its own initiative, assume a fact in the absence of proof to the contrary. See *Asser/Vonken 10-I* 2018/188. Vonken argues that such assumptions, which depend on the free, factual judgment of the court rather than the applicable substantive law, should be subject to the *lex fori*.

50 C.C. van Dam, 'Verantwoordelijkheid en aansprakelijkheid voor leveranciers en afnemers', *NTBR* 2022/45, p. 391.

Proposal, the liability rules provided for in Art. 22 Commission Proposal are applicable, irrespective of the law applicable pursuant to conflict rules.
This is a creative solution, but it differs considerably from the way in which the technique of designating certain provisions of national law as overriding mandatory provisions is traditionally applied. Traditionally, such 'lois d'application immédiate', as they are perhaps more aptly called in French, are provisions of a semi-public nature, serving important public interests of an – inter alia – socio-economic, cultural or political nature and having legal consequences for private relationships.[51] They are not subject to conflicts of laws rules but apply directly based on their own (territorial) scope. An example is the Dutch health and safety laws, which apply within the territory of the Netherlands, no matter which law applies to the agreement between employee and employer. As a result of designating all liability provisions implementing Art. 22 (which should logically also include the provisions implementing Art. 6, 7 and 8) as overriding mandatory provisions, a considerable extraterritorial effect is given to the *lex fori* of the home state.

To illustrate what Art. 22(5) Commission Proposal means in practice, I use the example of the Shell group as it was structured before 1 January 2022, when one of the two parent companies was a Dutch public limited company, having its head office in the Hague. If this were still the case, the Dutch parent company could be sued in the Netherlands (pursuant to Art. 4 juncto 63 of Brussels Ibis), in the case of damage caused in Nigeria by oil spills for which a Nigerian subsidiary is responsible. The Dutch court would then, pursuant to Art. 22(5) Commission Proposal, have to apply – as overriding mandatory obligations – those provisions of Dutch law that implement Art. 22 CSDDD, to determine the liability of the Dutch parent for failure to exercise due diligence under the Directive. However, the court would still have to determine the applicable law according to Art. 4 Rome II because Art. 22 Commission Proposal leaves several matters unregulated. Because this case concerns damage to the environment, the claimants may rely on Art. 7 Rome II, which allows them to – alternatively – found their claim on the law of the country in which the event giving rise to the damage occurred (*Handlungsort*). It is, however, not clear whether Art. 7 Rome II may lead to the application of Dutch law in this case. In the event of a spill caused by a defect of the pipeline (for which the Nigerian subsidiary is strictly liable as operator) Nigeria would be the country in which the event which directly gave rise to the damage occurred. Only if the parent's failure to act is qualified as 'the event giving rise to the damage' and if the locus of this omission is determined to be the parent's seat, the claimants can opt for the application of Dutch law.

In the climate case against Shell, the District Court The Hague ruled that Royal Dutch Shell's (RDS) adoption of Shell's group policy qualifies as an 'independent cause of damage' and determined that the *Handlungsort* was therefore in the Netherlands, where Shell was headquartered.[52] The District Court rejected RDS' plea that, in the event that a parent is called to account for non-intervention in subsidiaries, the *Handlungsort* is the place of the subsidiary's activities that the parent failed to manage. RDS referred to the CJEU's judgment in ÖFAB/Koot.[53] This case concerned jurisdiction pursuant to Brussels I in respect of a liability claim brought by a creditor against a board member and a shareholder of a company. The CJEU gave a preliminary ruling on the interpretation of 'the place where the harmful event occurred or may occur' in Art. 5(3) Brussels I. It held that "as regards actions seeking to hold liable a member of the board of directors and a shareholder of a limited company for debts of that company, that place is situated in the place to which the activities carried out by that company and the financial situation related to that company are situated". In the climate case against Shell, the District Court saw insufficient grounds to seek a link with ÖFAB/Koot. The District Court gave a broad interpretation to 'the event giving rise to the damage', having regard to the concept of protection underlying the choice of law in Art. 7 Rome II. The CJEU has not yet ruled on the meaning of the 'event giving rise to the damage' in Art. 7 Rome II, when a parent company is sued for failure to prevent environmental damage caused by a subsidiary.[54] Literature is divided.[55] Therefore, it cannot be ruled out that the CJEU may in such a case take the same approach as in ÖFAB/Koot. Going back to my example, this would mean that Nigerian law would apply, as the law of the country where the damage occurred and where it was directly caused, to, for example, the question of whether the Dutch parent is jointly and severally liable for damage caused by the subsidiary as well as the question how the damage is to be calculated.[56] Because Art. 22 Commission Proposal only seems to regulate civil liability for any damages that were actually caused, it is equally possible that Nigerian law would also apply to the question of whether the court can order the parent company to take measures (such as the

51 *Asser/Vonken 10-I* 2018/597.

52 District Court The Hague, 26 May 2021, ECLI:NL:RBDHA:2021:5339.

53 CJEU 18 July 2013, C-147/12, ECLI:EU:C:2013:490.

54 It is regrettable that the District Court The Hague did not *ex officio* request a preliminary ruling on the issue, see G. te Winkel & X.P.A. van Heesch, 'The Shell judgment – a bombShell in private international law?', *NIPR* 2021, p. 532-542.

55 See Giesela Rühl, 'Cross-border Protection of Human Rights: The 2021 German Supply Chain Due Diligence Act, 3 February 2022', www.ssrn.com, p. 11, with an overview of the opinions in literature in footnotes 74 and 75; Madeleine Petersen Weiner & Marc-Philippe Weller, 'The "Event Giving Rise to the Damage" under Art. 7 Rome II Regulation in CO_2 Reduction Claims – A break through an empty Shell?', 2 January 2023, https://conflictoflaws.net.

56 See Geert van Calster, 'The European Commission's Corporate Sustainability Due Diligence Proposal – Some thoughts on the conflict of laws', 25 March 2022, https://gavclaw.com/?s=due+diligence.

installation of an adequate leakage detection system) to prevent further spills from occurring.[57]

In the event that the parent company is sued for failure to prevent an adverse impact that did not result in environmental damage, claimants will not have the option of choosing the law of the *Handlungsort*. In such a case, the court will pursuant to Art. 4 Rome II apply the law of the host state to all matters that are not regulated by Art. 22 Commission Proposal. In this case, it is clear that Art. 22(5) Commission Proposal may only to some extent improve access to remedy for claimants. I should add that the Commission Proposal fails to address many issues that may be obstacles for potential claimants, such as the protection of witnesses and whistleblowers, limitation of claims, the availability of legal aid, the possibility of a claim being brought in the public interest or on behalf of claimants by, for example, NGO's and rules on the gathering of evidence. The failure to address these crucial issues has been criticised by many commentators.[58] It has also met with criticism from the Dutch government[59] and the Office of the UN Commissioner for Human Rights (OCHR).[60]

In the event that victims bring a claim against a non-EU-based company falling within the CSDDD's scope pursuant to Art. 2(2) Commission Proposal, Art. 22(5) Commission Proposal may fail to serve its purpose altogether. The reason for this is that Brussels Ibis does not offer a basis for jurisdiction in respect of companies domiciled outside the EU. Private enforcement of Art. 22 Commission Proposal will in such a case depend on the national provisions in respect of international jurisdiction. This is an issue that has been noted by several commentators, who have suggested aligning the jurisdiction of courts in respect of non-EU-based companies under the CSDDD's scope with the competence of the national supervisory authority, by basing jurisdiction on the domicile of the non-EU-based company's representative in the EU pursuant to Art. 16 Commission Proposal. Another solution would be to create a specific ground for jurisdiction, which could be the forum 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 (Art. 16(3) Commission Proposal).[61]

Art. 22(5) Commission Proposal is a creative way of solving the applicable law issue, but I doubt whether it should be adopted. Its merits can be questioned because several important aspects of CSDD claims against in-scope companies will still be governed by the host state's tort law, in spite of the considerable extraterritorial effect that Art. 22(5) gives to the *lex fori*. Leaving room for the application of the host state's law may diminish access to remedy and may also lead to uncertainty for both in-scope companies and victims. It causes me to wonder why Art. 22(5) is proposed, instead of adopting a special conflicts of laws rule in Rome II, giving the victims the option of founding their tort claim for failure of an in-scope company to exercise its duties under the CSDDD on the law of the Member State where the defendant company is domiciled.[62] Such a special conflicts rule may also result in giving extraterritorial effect to the *lex fori*, but it may be preferable to Art. 22(5) Commission Proposal as a means of ensuring both access to remedy[63] and legal certainty.

3. Summary of the Key Changes to Art. 22 Commission Proposal proposed in the EP Rapporteur's Draft Report and the Political Compromise's Compromise Text

A first key change to be noted, is that both the EP Rapporteur and the Political Compromise propose to strike the concept of the established business relationship from the CSDDD. The EP Rapporteur and the Political Compromise apply different techniques in order to achieve that the risk of liability for companies within the CSDDD's scope remains within reasonable bounds. The EP Rapporteur pro-

57 As I noted earlier, Art. 3:296 DCC offers a basis for such an injunction. However, this would not apply as part of the mandatory overriding law implementing Art. 22 CSDDD.

58 Liesbeth Enneking, 'Van beleid naar aangepaste zorgvuldigheid in mondiale waardeketens', *NTBR* 2022/43, p. 370; Shift, 'The EU Commission's Proposal for a Corporate Sustainability Due Diligence Directive – Shift's Analysis', March 2022, https://shiftproject.org/resource/eu-csdd-proposal/shifts-analysis/, p. 4-5; European Coalition for Corporate Justice (ECCJ), 'European Commission's proposal for a directive on Corporate Sustainability Due Diligence – A comprehensive analysis', 5 April 2022, https://corporatejustice.org/publications/analysis-of-eu-draft-directive-on-due-diligence/, p. 21; Nicky Touw, 'Civil liability in the EU proposal for a Corporate Sustainability Due Diligence Directive: a leap forward or stifling progress?', 22 March 2022, https://rethinkingslic.org/blog/tort-law/117-nicky-touw; Anne Lafarre, 'Mandatory Corporate Sustainability in Europe: The Way Forward', 21 April 2022, https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/mandatory-corporate-sustainability-due-diligence-europe-way-forward.

59 Nationaal Actieplan bedrijfsleven en mensenrechten, 2022-2026, 30 July 2022, https://www.rijksoverheid.nl/documenten/publicaties/2022/09/14/bijlage-1-nationaal-actieplan-bedrijfsleven-en-mensenrechten-nap-nederland, p. 73 ff.

60 OCHR, 'Feedback on the Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence', 23 May 2022, https://www.ohchr.org/sites/default/files/2022-05/eu-csddd-feedback-ohchr.pdf, p. 11.

61 Marion Ho-Dac, 'Brief overview of the Directive Proposal on Corporate Due Diligence and PIL', 27 April 2022, http://eail.org. See also Rui Dias, 'CSDD and PIL: Some Remarks on the Directive Proposal', https://conflictoflaws.net/2022/csdd-and-pil-some-remarks-on-the-directive-proposal/ and the Recommendation made on the occasion of the meeting on 9-11 September 2022 of the European Group of Private International law (GEDIP) concerning the Commission proposal, https://gedip-egpil.eu/en/2022/oslo-2022/.

62 In respect of non-EU domiciled companies within the CSDDD's scope, the jurisdiction issue first needs to be solved. If jurisdiction in respect of these companies could be based on the domicile of the representative, the conflicts rule could be aligned by giving victims the option of founding their claim on the law of the country where the representative is domiciled.

63 See Claire Bright, Maria Chiara Marullo & Francisco Javier Zamora Cabot, 'Private international law aspects of the Second Revised Draft of the legally binding instrument on business and human rights', *NIPR* 2021, p. 50-51.

poses that a company should only be liable for violations of Art. 7 and 8 CSDDD, if the company or a company under their control *caused or contributed to*[64] an adverse impact. The Political Compromise seeks to limit the risk of liability by introducing in Art. 22(1) an element of fault, by providing that the company must *intentionally* or *negligently* have failed to comply with the obligations laid down in Art. 7 and 8. Moreover, the Political Compromise proposes to clarify that as a result of this failure, "a damage to *the natural or legal person's interest protected under national law* was *caused*". The Political Compromise further proposes to add to Art. 22(1) that "a company cannot be held liable if the damage was *caused only by its business partners in the chain of activities*". The different approaches taken by the EP Rapporteur and the Political Compromise reflect the difficulties inherent in designing a harmonised civil liability regime for violations of CSDD duties. I believe that neither of these two approaches achieves the purpose of offering legal certainty to companies within the CSDDD's scope as well as victims of adverse impacts and ensuring, at the same time, the envisaged level playing field. The EP Rapporteur's proposal still leaves it to the courts to fill in what exactly is meant by 'contributing to', whereas the Political Compromise raises the question of what exactly is meant by 'negligence'.[65]

Together with the concept of established business relationship, the EP Rapporteur as well as the Political Compromise have struck the defence provided in Art. 22(2) Commission Proposal. Instead, Art. 22(2) as amended in the EP Rapporteur's report provides for a reversal of the burden of proof, if the claimant has provided prima facie elements substantiating the likelihood of the defendant's liability. In this case, the company has to demonstrate that it complied with its obligations under the Directive in order to escape liability. The Political Compromise does not propose a reversal of proof. It proposes to provide in Art. 22(2) that, if a company is held liable in accordance with Art. 22(1), the victim shall be entitled to full compensation for the damage in accordance with national law. However, the Political Compromise wishes to include that full compensation under the Directive "shall not lead to overcompensation, whether by means of punitive,[66] multiple or other types of damage".

The EP Rapporteur proposes to include in Art. 22(4) CSDDD a provision clarifying that the national law pre-empted by Art. 22 CSDDD includes rules on joint and several liabilities. The Political Compromise takes a different – and in my opinion, preferable – approach, by adding to Art. 22(3) CSDDD a provision ensuring joint and several liabilities in the event of damage caused jointly by the company and any of its subsidiaries or direct or indirect business partners. The approach taken by the Political Compromise, to include this in the provisions to be implemented by the Member States, ensures that joint and several liability applies as overriding mandatory law pursuant to Art. 22(5). This will not be ensured if joint and several liability may apply as part of the national law left untouched by Art. 22, as proposed in the EP Rapporteur's draft report.

Finally, the EP Rapporteur proposes to add a new paragraph 2 a to Art. 22 CSDDD, which contains several rules improving access to remedy. Member States must ensure that:

1) the limitation period for bringing actions for damages is at least ten years and that such period is to be interrupted or suspended, if the supervisory authority is taking action under Art. 18 CSDDD;
2) claimants are able to seek injunctive measures before Union courts, including summary proceedings. These shall be in the form of a definitive or provisional measure to cease an action which may be in breach of this Directive or to comply with this Directive;
3) measures (which may include legal aid) are in place to ensure that the costs of proceedings are not prohibitive for claimants;
4) measures are in place to enable trade unions and civil society organisations acting in the public interest to bring proceedings for the protection of a group of victims;
5) when a claimant provides elements substantiating the likelihood of a company's liability under Art. 22 CSDDD and has indicated that additional evidence is in the company's control, courts may order that such evidence be disclosed by the company in accordance with national procedural law.

Regrettably, the Compromise Text of the Political Compromise does not address these matters in any way.

Both the EP and the Political Compromise do not propose any changes or additions to Art. 22(5), thus leaving unaddressed the issues inherent in this provision that were identified in section 2.7 of this contribution.

4. Concluding Remarks

My conclusion is that Art. 22 CSDDD is not fit for achieving the purposes of effective compensation of victims – including access to remedy – as well as legal certainty and a level playing field, all at the same time. By aiming for these three goals simultaneously, the Commission is trying to achieve too much. The three aims mentioned are always hard to reconcile, but this task becomes daunting when the laws of 27 different Member States need to be harmonised. The

64 I remind the reader (see footnote 23) that this terminology is used in Art. 19 UNGP.

65 Art. 6:162(3) DCC provides that a tortious act can be attributed to the tortfeasor if it results from his fault or from a cause for which he is responsible at law or pursuant to generally accepted principles. From this Dutch perspective, it is not clear what exactly is meant by 'negligence' as a basis for attribution of a tort to a tortfeasor. Does it mean 'fault'?

66 This raises the question of which Member States' laws recognise the possibility of punitive damages as this seems to be a phenomenon that is a feature of common law systems rather than civil law systems. Since Brexit, the only EU Member State with a common law system is Ireland.

mission becomes impossible, if the policy is maintained not to interfere too deeply in Member States' national tort laws. Member States' general tort laws have not been subject to harmonisation and differ considerably. This is certainly the case where it concerns the liability of companies for damage caused by the activities of subsidiaries or other businesses in the value chain. Moreover, the development of Member States' laws in this domain has only recently started, meaning that there is no solid basis to build on. For these reasons, I believe that any ambitions of the European legislature in this domain should be modest.

Some will say that modesty is reflected in the Commission's policy to leave many matters to national law. In my opinion, the choice to leave unregulated several matters that may be crucial for access to the remedy of civil liability does not qualify as modesty but as a regrettable failure to understand what is really necessary to ensure access to remedy. By ignoring procedural and practical hurdles for claimants, the Commission Proposal utterly fails to achieve both the aim of achieving a level playing field as well as the aim of ensuring effective access to remedy for victims. In order to achieve these aims, it seems crucial that the many procedural and practical hurdles for claimants mentioned in section 2.7 are addressed, as proposed in the EP Rapporteur's Report. Therefore, my first suggestion to the European legislature is to shift the focus of the proposed CSDDD from (partly) harmonising substantive law to harmonising crucial procedural aspects of civil liability claims for CSDD violations.[67] I add that more attention should also be paid to stakeholder engagement aimed at providing other remedies.[68] (Too) much seems to be expected from civil proceedings, which are – to put it mildly – not the most efficient way of obtaining a remedy, in particular if the aim is to prevent further harm.

My second suggestion is to remove the limitation of the CSDD duties to subsidiaries and direct and indirect business partners with which the company has an established relationship. Instead, the CSDDD should provide for risk-based CSDD, clarifying that companies may prioritise risks[69] for the purpose of deciding to what extent appropriate measures should be taken to address these risks and to assess which measures are necessary. It is clear that liability should not automatically be linked to any failure by a company to exercise due diligence in its value chain under the CSDDD. But I doubt whether any of the two techniques used by respectively the EP's Rapporteur and the Political Compromise in order to limit the liability risk for companies should be adopted in the final version of the Directive. Adoption of either technique will still leave much to be filled in by Member States' courts. In my opinion, the European legislature should not embark upon a mission impossible to harmonise – with the aim of achieving a level playing field and legal certainty – the requirements that must be met for a company to be held civilly liable for violating its CSDD duties in the Directive. This is better left to further development in national courts.

From a Dutch perspective, the remedy of civil liability seems inherent in the codification of the duties for companies within the CSDDD's scope to identify potential adverse impacts (Art. 6 CSDDD), to take appropriate measures to prevent or adequately mitigate potential adverse impacts that should have been identified (Art. 7 CSDDD) and to take appropriate measures to bring actual adverse impacts to an end or minimise them (Art. 8 CSDDD). Failure to observe these duties will qualify as a violation of a duty of care owed by the parent to those in whose interest the company should have exercised due diligence. This will, if the other requirements for tortious liability are met, give rise to liability of the company that violated its CSDD duties. For civil liability under Dutch law, it is crucial that Arts. 6, 7 and 8 CSDDD ensure that companies at the top of value chains will no longer be able to look away, claiming that they have no responsibility in respect of risks of adverse impacts on human rights and the environment resulting from the activities of other entities in the value chain. Art. 22 Commission Proposal does not have much added value for liability under Dutch law.

However, Art. 4 Rome II Regulation may prevent the court from applying Dutch law if the damage is caused in a third country by one of the partners in the value chain headed by a Dutch company. In this event, Art. 22(5) Commission Proposal would ensure that the Dutch provisions implementing Art. 22 apply, irrespective of the law of the third country that would apply on the basis of conflicts law. The question, therefore, seems to be – at least from my Dutch perspective – whether Art. 22 Commission Proposal should be retained in some form, to ensure that victims in host countries outside the EU can benefit from the protection offered by the home country's law. In section 2.7, I expressed my doubts in respect of Art. 22(5) Commission Proposal and suggested another way of ensuring that the victims can – if they choose to do so – base their claim on the tort law of the home state. A special conflicts rule giving victims the option to base their claim on the law of the country where the defendant in-scope company is domiciled could be incorporated in Rome II.

Finally, I suggest that the EU should create a database of case law, if the CSDDD is adopted, with or without a provision on civil liability. Such a database may be of assistance to courts across the EU, to all companies that are affected by the CSDDD and their counsel and to victims and their counsel.

67 I note that this approach is followed in Art. 3.2.6 of the Dutch Bill containing rules for due diligence in production chains in order to prevent violations of human rights, labour rights and the environment, that is currently pending in Parliament (*Kamerstukken II* 2022/23, 35761, nr. 9).

68 OCHR Feedback, 23 May 2022, https://www.ohchr.org/sites/default/files/2022-05/eu-csddd-feedback-ohchr.pdf, p. 12-13.

69 See Art. 6a CSDDD as proposed by the Political Compromise.

Alessio M. Pacces[1]

Civil Liability in the EU Corporate Sustainability Due Diligence Directive Proposal: A Law and Economics Analysis

Ondernemingsrecht 2023/37

- **Put on the company the burden of proving compliance with due diligence obligations.**
- **Remove the exclusion of liability if the damage is caused only by the business partner.**
- **Define objective criteria to prioritize actual and potential adverse impacts.**

The EU Corporate Sustainability Due Diligence Directive (CSDDD) proposal can be interpreted as an attempt to cope with the underdeterrence of negative externalities on human rights and the environment depending on the strategic use of limited liability by corporate groups. This article reviews the civil liability proposals by the Commission, the European Parliament, and the Council from this law & economics perspective. The article finds that these liability rules fall short of making corporations internalize negative externalities by way of due diligence obligations in the group and the supply chains. It is relatively easy for companies that fail to carry out due diligence effectively to avoid the civil liability being considered by the EU legislature.

1. Introduction

This article concerns the proposed EU Corporate Sustainability Due Diligence Directive (henceforth CSDDD).[2] It focuses on civil liability as a mechanism for companies to internalise negative externalities within their group and supply chains.[3] Therefore, this article analyses the CSDDD from a functional perspective, using economic analysis to identify the expected impact of the proposed legal rules on a company's conduct. The analysis focuses on the incentives created by the existing and the proposed rules governing liability for corporate damages. This analysis refers to the Commission's CSDDD proposal, although it will consider the more recent text proposed by the Council as Political Compromise in the negotiations with the European Parliament (hereinafter, EP).[4] At the moment of writing, the text which will form the basis of the so-called 'Trialogue' is not known.[5]

I have divided the remainder of this article into five parts. In Section 2, I will describe the operation of the rule establishing liability for damages in the value chain, i.e. Art. 22 of the CSDDD proposal. This is mainly, albeit not exclusively, a liability for damages occurring in the supply chain of Multi-National Corporations (MNCs).[6] In Section 3, I will discuss the economic aspects of this liability. I have chosen to take a functional approach to civil liability, based on economic analysis, to answer the question: what is the goal of a supply chain liability? In theory, such a liability aims to counter the strategic use of limited liability by corporations to avoid paying damages for their wrongdoings and, in such a way, avoid internalising the negative externalities of their operations. However, not all theories are good representations of reality. Therefore, in Section 4, I will discuss the empirical studies showing that the strategic use of limited liability is a reality, indeed, both in the context of groups of companies and in the construction of supply chains.

As the proposal to establish a supply chain liability seems to be well grounded in theory and empirically, the EU could play a leading role in making MNCs internalise the

1 Alessio Maria Pacces is Professor of Law & Finance and Director of the Amsterdam Center for Law & Economics (ACLE) at the University of Amsterdam. He is also research member of the European Corporate Governance Institute (ECGI) and academic fellow of the European Banking Institute (EBI).

2 Commission's Proposal for a Directive of the European Parliament and of the Council on the Duty of Business Diligence for Sustainability and amending Directive (EU) 2019/1937, No. 2022/0051 COD of 23 February 2022.

3 Art. 20 of the CSDDD proposal also requires Member States to adopt administrative 'sanctions' ('penalties' in the Council's Political Compromise, see *infra*, note 4) for violations of the national provisions implementing the Directive. Although these sanctions contribute to deterrence, they are out of the scope of this article.

4 Council of the European Union, Proposal for a Directive of the European Parliament and of the Council on the Duty of Business Diligence for Sustainability and amending Directive (EU) 2019/1937 – General Approach, No 15024/1/22 REV1 of 30 November 2022 (hereinafter, Political Compromise). The European Parliament's Committee on Legal Affairs published a Draft Report, which is not yet final. Lara Wolters (Rapporteur), Draft Report on the proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 of 7 November 2022 (hereinafter, Wolters Report).

5 Trialogue is the informal negotiation between the Council and the European Parliament preceding the approval of an identical text by the two EU institutions, as required by the ordinary legislative procedure. See Art. 294 of the Treaty on the Functioning of the European Union (TFEU).

6 A key provision to define the scope of the CSDDD is Art. 6, which requires companies to identify actual and potential adverse impacts on human rights and the environment from their own operations, that of their subsidiaries, and from the relevant business partners in the value chain. The Commission's proposal defined 'value chain' broadly (Art. 3(g)), though it restricted the relevant business partners to 'established business relationships' (Art. 3(f)). To accommodate divergent views of Member States on whether the CSDDD should cover the entire value chain or limit its scope to the supply chain, the Council's Political Compromise has adopted the term 'chain of activities', which focuses mainly on the supply chain. See Political Compromise, Accompanying Report, p. 6. The Council's proposal has abandoned the concept of 'established business relationships' and applies to the operations of all direct and indirect business partners in the supply chain, but only to the direct downstream partners (Art. 3(g) in the Political Compromise).

negative externalities they generate worldwide. However, as I will explain in Section 5, this liability does not work very well as currently designed. The Commission's original proposal was easy to circumvent. In overhauling the civil liability provision, with the aim to clarify its legal basis, the Council has arguably made supply chain liability even easier to get around. In Section 6, I will conclude that the current CSDDD proposal is a missed opportunity to make companies internalise their negative externalities on human rights and the environment.

2. Civil Liability in the CSDDD Proposal

Art. 22 of the CSDDD requires Member States to impose on the companies in scope civil liability for breach of the due diligence obligations established by the Directive.[7] Taking a functional approach, in this section I will focus on the key aspects of this liability rule.

Companies subject to the Directive will be liable for the damages resulting from adverse environmental or human rights impacts that occur in three contexts: i) in the company's own operations; ii) in the company's subsidiaries; and iii) in the operations of direct or indirect business partners in the value chain. In the Commission's proposal, 'value chain' was defined broadly although its relevance was confined to 'established business relationships.'[8] Reflecting the EP's stance, the Council's Political Compromise has scrapped the concept of 'established business relationships.'[9] Departing from the EP's approach,[10] however, the Council also replaced 'value chain' with a novel definition of value 'chain of activities', narrowing down the scope of the Directive to the upstream business partners and adding only the *direct* downstream partners.[11] Thus, the Council's version mainly results in a supply chain liability. The different opinions of the EP and the Council about the scope of the Directive are not surprising, because the inclusion of indirect business partners in the scope of a company's liability is a sensitive aspect of the CSDDD proposal.

In any of these contexts – own operations, subsidiaries operations, and operations of direct and indirect business partners – a company is liable if it has failed to carry out the actions that qualify as 'due diligence' according to the Directive.[12] In the CSDDD, due diligence is not a mere standard of care in monitoring, but it means specific statutory obligations. The companies in scope must not only monitor their own operations, their subsidiaries, and the business partners in the supply chain through procedures, policies, and codes of conduct aiming to identify adverse impacts on the environment and human rights, as defined by the lists of international conventions in the Annex of the CSDDD proposal.[13] Most importantly, the companies must also prevent, or at least adequately mitigate, the potential adverse impacts (Art. 7) and bring to an end, or at least minimise the extent of the actual adverse impacts (Art. 8). If a company fails to comply with Art. 7 and Art. 8 of the CSDDD, it may be liable for the damages resulting from these adverse impacts, even if these are remote because, for example, the company's business partners in Asia or Africa pollute or use child labour in violation of the relevant international conventions.

The scope of the supply chain liability depends on the definition of business partners, especially the indirect ones. As in the above example, liability may arise from indirect partners who are very remote, both geographically and in contractual terms, from the MNC. In the Commission's proposal, the relevant partners were those falling within the definition of 'established business relation-

7 According to Art. 4 CSDDD, the due diligence obligations of the companies are as follows:
"a) integrating due diligence into their policies and risk management systems 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."
See for a more in-depth discussion of Art. 22: Loes Lennarts, *Ondernemingsrecht* 2023/36.

8 See Art. 3(f)(g) CSDDD, Commission's proposal (emphases added):
- "'**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;
- '**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."

9 According to Art. 3(e) in the Political Compromise (emphases added), "'**business partner**' means a legal entity:
i. with whom the company has a commercial agreement related to the operations, products or services of the company or to whom the company provides services pursuant to point (g) ('direct business partner'), or
ii. which is not a direct business partner but which performs business operations related to the operations, products or services of the company ('indirect business partner')."

10 See Amendment 74 Wolters Report (emphases added): "'**value chain**' means *all upstream* and *downstream* activities, operations, including marketing and advertising related to, and entities involved in, the production and supply 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."

11 See Recital 18 and Art. 3(g) in the Political Compromise, specifying that downstream activities are to be included in the '**chain of activities**' only "where the business partners carry out those activities for the company or on behalf of the company".

12 Art. 22 CSDDD specifically attaches liability to the breach of Art. 7 and 8 CSDDD, which focus on the purpose of due diligence.

13 Art. 4 to 11 CSDDD.

ships' in the value chain.[14] The Wolters Report removed the restriction of established business relationships, effectively extending the scope of liability to *all* direct and indirect business partners.[15] The Council's Political Compromise is not only more restrictive as it excludes indirect downstream partners from the relevant definition of 'chain of activities',[16] but also explicitly defines business partners without reference to the duration or intensity of the relationship.[17] Although it is difficult to predict the outcome of the legislative process at this stage, it seems clear that the presence of an established business relationship will no longer be a precondition.

The different approaches to the value chain definition have important repercussions on the liability rule. Understandably, the EU legislature has been concerned about limiting the liability for damages caused by indirect partners, for not all these damages can be avoided, or limited, by the company's due diligence. Recital 15, which the EP and the Council left substantively unchanged, clarifies that due diligence must be understood as obligations of means, not of result. In the same vein, the EU legislature has identified situations in which the liability for damages caused by particularly indirect business is excluded. These exclusions differ in the Commission's and in the Council's text.

In the Commission's proposal, liability for indirect partners could be excluded under two conditions. The first was the presence of 'contractual cascading' by which business partners are seeking contractual assurance from their own contract partners about compliance with the company's code of conduct and, as necessary, preventive action plans. The second condition was that the contractual cascades be accompanied by appropriate measures of 'compliance verification', including – but not necessarily – independent third-party verification.[18] Meeting these box-ticking conditions was, however, insufficient to exclude liability if "it was unreasonable […] to expect that the action actually taken […] would be adequate to prevent, mitigate, bring to an end or minimise the extent of the adverse impact."[19] With this structure, the enforcement of the liability rule critically depends on who has to prove that the action was unreasonable. Albeit eliminating reliance on contractual cascading as an exculpatory mechanism, the EP maintained the rule's structure. According to the Wolters Report, a company should be able to escape liability by demonstrating compliance with the due diligence obligations in general, "unless it was unreasonable […] to expect that the action actually taken […] would be an appropriate measure to prevent, mitigate, bring to an end or minimise the extent of the adverse impact."[20] Although the EP's language suggests that defendant companies must demonstrate compliance, the burden of proving the unreasonableness of the action is still open for discussion.[21]

The Council's Political Compromise completely overhauled the liability rule. Although it is unclear which approach will become final, it is interesting to compare the exclusions of liability. The Council's version of Art. 22 maintains that a company faces liability when: a) it breaches the due diligence obligations established by Art. 7-8; b) damage occurs because of this breach. However, the text is now explicit about two additional requirements. First, the breach of duty should be intentional or negligent. Second, there must be no break in the causation link, that is, liability is excluded if the damage was caused *only* by the business partner. Consequently, there is no additional exculpatory provision for the company. Although the Council presents these as mere legal clarifications, they will have an impact on the implementation by Member States, notably on the burden of proving the four conditions for liability, which by default lies with the plaintiff.[22] Moreover, as we have seen, the Council's text has limited the scope of due diligence obligations with regards to downstream indirect partners and has added an additional nuance: prioritisation.[23] In order for a company to be in breach of Art. 7-8, the failure must concern adverse impacts on human rights or the environment that are considered a priority in light of their 'severity' and 'likelihood', provided that it is 'unfeasible' for the particular company to address all adverse impacts at the same time. This vague language leaves companies plenty of room to escape liability.

The conditions introduced by the Council's Political Compromise replace the explicit exclusions in the Commission's and the EP's proposals. Arguably, the Council's requirements are more demanding, making it harder for a company to face liability for damages occurring in its supply chain.

3. Economic Function of Civil Liability: The Problem of Limited Liability

To evaluate the different models of value/supply chain liability being considered by the EU, let me take a step back and look at the purpose of this type of liability. This can be understood based on the economic rationale for tort liability. From an economic standpoint, the main function of tort liability is deterrence.[24] Tortfeasors facing liability are deterred from imposing damages on other members of so-

14 *Supra*, note 8.
15 *Supra*, note 10.
16 *Supra*, note 11.
17 *Supra*, note 9.
18 See Art. 22(1) and Art. 7(2)(4) and 8(3)(5) CSDDD.
19 Art. 22(2) CSDDD.
20 Amendment 198 Wolters Report.
21 See *infra*, Section 5.
22 Typically, in civil law jurisdictions, the plaintiff in a tort liability case must prove: 1) a damage; 2) a breach of duty; 3) the causal link between the breach and the damage; 4) the fault of the person in breach (intention or negligence). See e.g. Art. 162 BW6 Dutch Civil Code and Art. 2043 of the Italian Civil Code. See also Political Compromise, Accompanying Report.
23 Art. 6a in the Political Compromise.
24 Steven Shavell, *Foundations of Economic Analysis of Law*, 2004, Harvard University Press, 175 ff.

ciety. Put differently, tort liability incentivises tortfeasors to internalise the negative externalities of their activities on the victims. Think, for example, of car accidents: liability (as the no-claim bonuses of liability insurance) incentivises drivers to pay attention to other people's vehicles. Generally, whenever the social cost of an activity exceeds the private cost, liability aims to prevent private actors, who only bear the private cost, from creating excessive damage compared to the social optimum. The same logic applies to environmental damage and human rights violations. By requiring damage compensation equal to the social harm, liability bridges the gap between the social and private costs of environmental and human degradation. Although describing such degradations as negative externalities may sound odd, economists using this language aim to constrain these market failures as much as possible.[25]

In a 1991 seminal article, Hansmann and Kraakman identified a major shortcoming in tort liability's capacity to foster the internalisation of negative externalities: corporate limited liability.[26] Limited liability can undermine tort liability's deterrence because it allows corporations to be judgement proof.[27] The judgment proofness problem arises not so much because tortfeasors unexpectedly face liability for damages exceeding their net worth, but much more often because they strategically put themselves in this situation. It is easy for MNCs to concentrate on dangerous activities that can cause, for example, exorbitant environmental damage in tiny capitalised corporate vehicles. In this way, should the victims sue, the defendant company would not be able to pay damages. Judgment proofness results in underdeterrence: when deciding whether to undertake a dangerous activity within the corporate group, the parent company may disregard the negative externalities if tort liability is only faced by subsidiaries unable to pay damages.

To foster the internalisation of externalities via tort liability, Hansmann and Kraakman proposed to abolish corporate limited liability with regards to tort victims. If tort victims are able to claim damage compensation from the entire group's assets, the parent companies will internalise the externalities and have incentive to minimise the social harm of their activities wherever these are carried out in the group. However, unlimiting the limited liability of MNCs is complex because corporate law varies internationally. Anticipating a race-to-the-bottom competition between jurisdictions,[28] Hansmann and Kraakman also proposed that corporate unlimited liability towards tort victims had an extraterritorial effect. In particular, in applying tort law, the United States should disregard the limited liability conferred by other jurisdictions.[29]

Hansmann and Kraakman's article is a milestone in the economic analysis of corporate liability. Because of corporations' political clout, their proposal did not get much traction in legislatures or courts. It is worth noting that even unlimited liability would not completely disallow the circumvention of tort liability (hence the internalisation of externalities) by corporate groups. Even if parents were facing unlimited liability for their subsidiaries' actions, MNCs could still avoid liability risk by outsourcing the most dangerous activities to their business partners in the supply chain. Hansmann and Kraakman were aware of this problem, although this did not affect their proposal because it is impossible to predict whether outsourcing would increase or decrease in a counterfactual unlimited liability regime.[30]

From a law & economics standpoint, the CSDDD proposal can be interpreted as an attempt to cope with underdeterrence of environmental and human rights violations stemming from limited liability in corporate groups.[31] Functionally, the CSDDD extends corporate liability to the operations of subsidiaries and of business partners in the value chain. However, this liability is not constructed as tort liability for damages caused by subsidiaries or business partners, which would directly address the limited liability problem, but it is rather liability for breach of due diligence obligations in dealing with the subsidiaries and the business partners in scope.[32] In the Commission's proposal, the key concept defining the scope of liability was the presence of an 'established business relationship' with the business partners. As this concept was removed by the EP and the Council, and the two institutions' attitudes towards the scope of the CSDDD differ, it is impossible to predict what the scope of MNC liability will be. Yet, whichever definition the EU legislature will eventually adopt, companies will be liable for the damage caused by subsidiaries and some business partners, so long as these damages result from a breach of the due diligence obligations – a point on which I will return in Section 5.

25 In economics, however, the optimal level of negative externalities is not zero. There are two reasons for this. First, even if all negative externalities were internalised, it would be efficient to carry out harmful activities so long as the social benefits (including the tortfeasor's private benefits) exceed the social costs. Secondly, because internalizing externalities is costly (for instance, due to the administrative cost of tort liability), it would not be in the public interest to bring negative externalities to zero. See Shavell, *supra* note 24, 80-83.

26 Henry Hansmann & Reinier Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts', *Yale Law Journal*, 1991, 1879-1934.

27 Steven Shavell, 'The Judgment Proof Problem', *International Review of Law and Economics*, 6(1), 1986, 45-58.

28 See e.g. Lucian A. Bebchuk, 'Federalism and The Corporation: The Desirable Limits on State Competition In Corporate Law', *Harvard Law Review*, 1992, 1435-1510.

29 Hansmann & Kraakman, *supra* note 26, 1921-23.

30 Hansmann & Kraakman, *supra* note 26, 1913-16. But see *infra*, text accompanying notes 37-38, for more recent empirical evidence on outsourcing.

31 Interestingly, Recital 56 of the in the Political Compromise speaks against deterrence thorough damages, although that must be read in the context of the prohibition of punitive damages and other forms of overcompensation.

32 See Anne Lafarre, 'Mandatory Corporate Sustainability Due Diligence in Europe: The Way Forward', *ECGI Blog*, 12 April 2022, https://ecgi.global/blog/mandatory-corporate-sustainability-due-diligence-europe-way-forward.

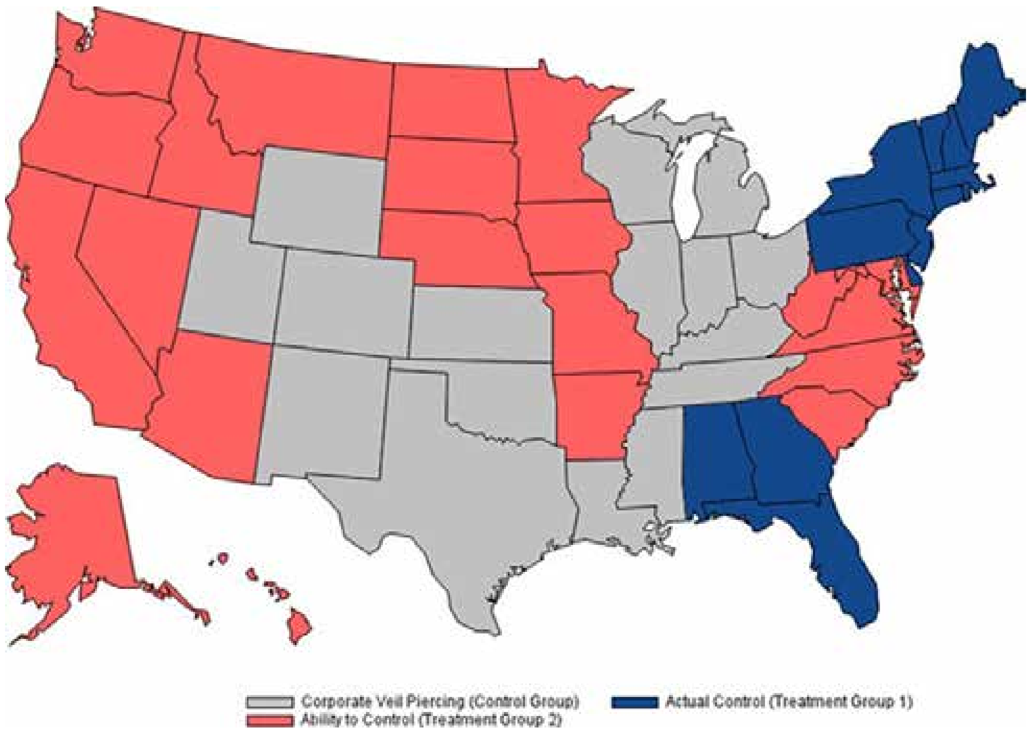
4. Strategic Use of Limited Liability: Empirical Evidence

A supply chain liability seems to be justified, in theory, to cope with the strategic use of limited liability by corporations. The question remains whether corporations actually use limited liability strategically. This is an empirical question. Recent empirical work in financial economics has answered this question in the affirmative, with regards to both groups of companies and the construction of supply chains.

As far as a group of companies are concerned, Professors Akey and Appel have recently demonstrated that limited liability increases the corporation's incentive to externalise environmental damage. When corporations benefit from limited liability, they pollute more.[33] The challenge of empirical studies, especially studies of the impact of law on finance, is to identify causality. This is because two phenomena such as limited liability and environmental damage could be statistically correlated, but both depend on a variable omitted from the study which, in reality, determines the production of negative externalities.[34] Having published their study in the Journal of Finance, the world leading scientific journal in financial economics, the authors had a convincing strategy to prove causality.

Professors Akey and Appel used a US Supreme Court case, the *Bestfoods* case from 1998, to tease out the causal impact of limited liability.[35] In empirical jargon, *Bestfoods* is a (quasi-)natural experiment, which alters the rule of law in certain jurisdictions leaving it unchanged in other, comparable jurisdictions. Similarly to the randomised controlled trials of medications, this setting allows for identifying the effect of legal change. Prior to *Bestfoods*, the US federal courts applied different standards to establish the parent's liability for the environmental damage caused by subsidiaries. Some courts held the parent company liable if it could *potentially* exercise control over the subsidiary. Others required that the parent exercised *actual* control. Others still applied state corporate law, which in the US allows piercing the corporate veil only in extreme cases of fraud or subsidiaries being the 'alter ego' of the owner.[36] In *Bestfoods*, the Supreme Court ruled that, in the US, parent companies can only be liable for the environmental damage by their subsidiaries if the

Figure 1



Source: Pat Akey and Ian Appel, 'The Limits of Limited Liability: Evidence from Industrial Pollution', *Journal of Finance*, 76(1), 2021, 12.

33 Pat Akey & Ian Appel, 'The Limits of Limited Liability: Evidence from Industrial Pollution', *Journal of Finance*, 76(1), 2021, 5-55.

34 Vladimir A. Atanasov & Bernard S. Black, 'Shock-Based Causal Inference in Corporate Finance and Accounting Research', *Critical Finance Review*, 5, 2016, 207-304.

35 *United States v. Bestfoods*, 524 U.S. 51 (1998), https://supreme.justia.com/cases/federal/us/524/51/.

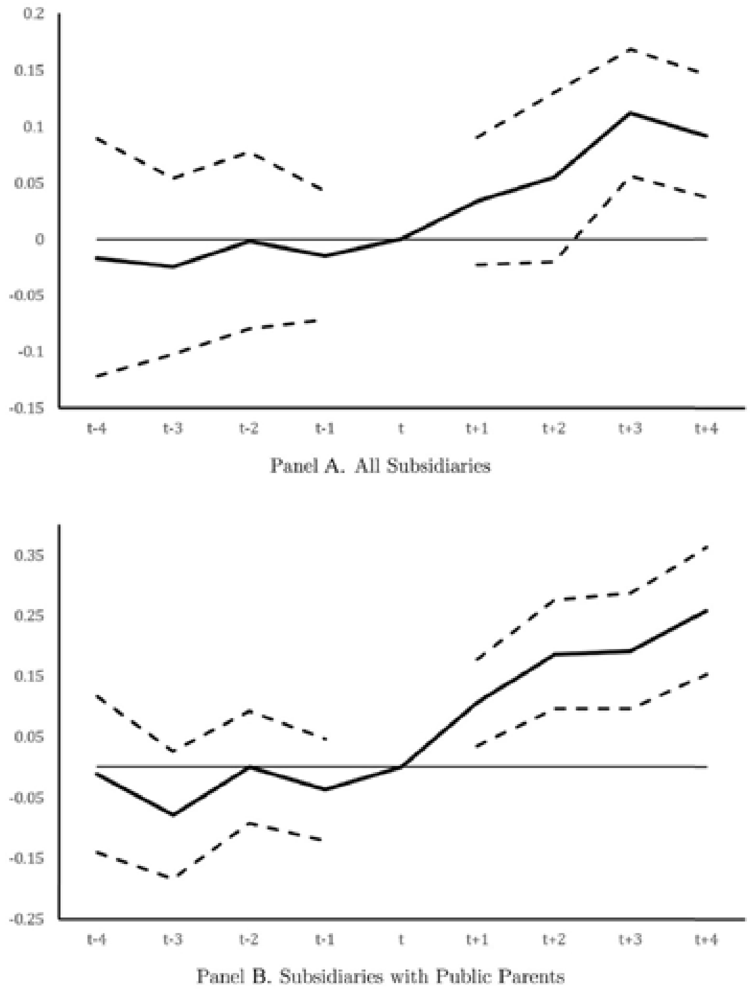
36 Frank H. Easterbrook & Daniel R. Fischel, *The Economic Structure of Corporate Law*, 1996, Harvard University Press, 54-59.

conditions for veil piercing apply. This implied that some parent corporations suddenly enjoyed the protection of limited liability, which they did not have before. Figure 1 illustrates the situation before *Bestfoods*.

The grey states are those in which parent companies have always enjoyed limited liability, except for veil piercing under state law. The blue states disregarded limited liability also in case of actual control whereas, in the red states, the parent would be liable even if it could exercise control only potentially. After *Bestfoods*, all states suddenly become grey. Empirically, this is an opportunity to identify the causality of limited liability on pollution, which increased in the US after *Bestfoods*, but possibly due to other reasons. Analysing how subsidiaries with plants in blue or red states behave, after *Bestfoods*, in comparison with subsidiaries having plants in grey states allows identifying limited liability's impact on environmental damage, measured as change in pollutant emissions. According to Akey and Appel, the impact is significant: subsidiaries benefiting from limited liability increased pollutant emissions by 5% to 9%, on average, compared to subsidiaries which already enjoyed limited liability.

The graph in Figure 2 illustrates the increase in pollutant emissions from the year of *Bestfoods* (1998), indicated as time t. In the upper part of the graph, which concerns all subsidiaries affected by *Bestfoods*, one can see the significant increase in the curve's slope from time t. This shows that the subsidiaries affected by *Bestfoods* increased their emissions, year after year, up to time t + 3. In the lower part of the graph, the analysis is only about subsidiaries having a parent listed on the stock market. The increase in pollution (the curve's slope) is higher than for the universe of the subsidiaries affected by *Bestfoods*. When the parent company is listed, subsidiaries have a higher incentive to externalise environmental damage taking advantage of limited liability, probably because the managers of the parent company, who make decisions, are more sensitive to pay-per-performance.

Figure 2



Source: Pat Akey and Ian Appel, 'The Limits of Limited Liability: Evidence from Industrial Pollution', *Journal of Finance*, 76(1), 2021, 28.

As hinted in the previous section, companies may also make strategic use of limited liability by outsourcing dangerous activities to formally separate corporations in the supply chain. Because the study of supply chains in law & economics is relatively recent, the empirical analyses of this topic have not yet been published. However, there are two working papers showing, with a solid strategy to identify causality, that companies react to the increased liability risks from negative externalities, such as health damage or pollution, by outsourcing dangerous activities to their partners in the supply chain.

The first study by Professor Adrian Lam uses, as a natural experiment, the designation of a substance as carcinogen by the US National Toxicology Program.[37] From the moment of designation, it becomes clear that the use of the substance in the production process exacerbates health risk. Therefore, companies that use the substance face greater liability risk than companies that do not use it. By comparing the behaviour of these two types of companies, before and after the designation, causality can be established. Professor Lam's main result is that, after designation and presumably because of it, companies reduce the carcinogen's use, but the use of the substance does not decrease in the aggregate. While some companies reduce carcinogen use, others increase it, and the net impact on the negative externality is zero. Tort liability doesn't deter.

After the carcinogen designation, companies redraw their firm boundaries, and particularly their supply chains, to minimise liability risk. Firstly, companies sell assets using the designated substance. The second effect of the designation is that companies using carcinogens outsource more, that is, they stop using the carcinogen directly while buying more inputs from suppliers that may use them facing lower liability risk. This effect is, on average, statistically significant and economically large. The impact of carcinogen designation on the levels of outsourcing is four times higher if the company has already been sued for health damage.

The strategic use of supply chains to minimise liability risk is confirmed by another recent working paper by Professors Rand Duchin, Janet Gao, and Qiping Xu, studying the asset market for industrial pollution.[38] The authors find that, following environmental risk incidents, companies divest polluting plants. While pollution does not decrease at the level of sold plants and in the aggregate, again revealing a failure of tort liability to deter negative externalities, divesting companies enjoy higher Environmental, Social, and Governance (ESG) ratings and face lower regulatory compliance costs, including liability risk. Interestingly, buyers of divested assets tend to be firms with pre-existing relationships or joint ventures with the sellers, allowing the latter to maintain their access to the sold assets.

The empirical evidence to date confirms that companies use limited liability strategically, not only in corporate groups, but also by reshaping the firm boundaries and supply chains to minimise liability risk. This strategic behaviour of corporations undermines tort liability's function to foster the internalisation of negative externalities.

5. Getting Around Civil Liability in the CSDDD Proposal

The foregoing discussion reveals that a supply chain liability is theoretically justified, as it would reduce the company's ability to externalise social harm by structuring corporate groups and supply chains strategically, to evade tort liability. This concern is also borne out by the empirical evidence. Armed with these insights, I come back to the CSDDD proposal to show that, as it stands, the liability established by Art. 22 is very easy to circumvent.

Firstly, any attempt to impose functionally unlimited liability on MNCs must reckon that limited liability is a privilege from national corporate law. For this reason, Hansmann and Kraakman's proposal included an element of extraterritoriality. Also, the CSDDD proposal seeks to impose due diligence obligations to companies outside the EU, but the effectiveness of this strategy is questionable. Companies incorporated outside the EU are subject to the Directive if they exceed a turnover threshold in the EU.[39] However, because the turnover is not consolidated, this provision can be circumvented by operating in the EU through many small companies. Most importantly, to avoid the CSDDD, it suffices for a third-country corporation to operate via subsidiaries incorporated in an EU Member State, as is normally the case. While the subsidiaries would be individually subject to the CSDDD, the CSDDD would not apply to the non-EU parent company, which might be the one where the group's net worth is concentrated.[40]

There is another way to evade the CSDDD liability. To determine whether a company is a subsidiary, potentially exposing the parent company to liability, the CSDDD refers to

37 Adrian Lam, 'Do Health Risks Shape Firm Boundaries?', *Working Paper* (July 2022), https://sites.google.com/view/adrianlam.

38 Duchin, Ran, Janet Gao & Qiping Xu, 'Sustainability or Greenwashing: Evidence from the Asset Market for Industrial Pollution', *Working Paper* (October 2022), available at SSRN: http://dx.doi.org/10.2139/ssrn.4095885.

39 See Art. 2(2) CSDDD, defining the EU turnover thresholds for high-risk sectors and in general.

40 According to Professors Luca Enriques & Matteo Gatti, 'The Extraterritorial Impact of the Proposed EU Directive on Corporate Sustainability Due Diligence: Why Corporate America Should Pay Attention', *Oxford Business Law Blog*, 21 April 2022, https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/extraterritorial-impact-proposed-eu-directive-corporate, a US parent company incorporated in Delaware could be indirectly affected by the CSDDD. Under Delaware law, directors may face duty of care liability if they fail to monitor their subsidiaries. Thus, directors of a Delaware company may be liable towards their shareholders if the European subsidiaries do not comply with the EU due diligence obligations and must pay damages because of that.

the notion of 'controlled undertaking' in the Transparency Directive.[41] Thus, a company qualifies as a subsidiary for the purpose of due diligence obligations if the parent controls it, *de jure* or *de facto*, according to the Transparency Directive.[42] *De jure* control is straightforward as it stems from a majority of voting rights or the right to appoint the majority of directors. *De facto* control is defined by a vaguer notion of 'dominant influence'.[43] A simple way to get around the CSDDD is, therefore, to avoid the subsidiary designation by refraining from exercising a dominant influence on the company responsible for environmental or human rights violations, while maintaining effective control in some subtler way. This strategy would be ineffective, however, if the scope of the supply chain liability was broad enough to include the companies escaping the subsidiary designation as business partners of the parent company, which would still be subject to due diligence obligations and liable for failure to comply with them.

Ultimately, the CSDDD's ability to prevent companies from using limited liability to externalise social harm depends on the credibility of liability for the actions by business partners, i.e., of the supply chain liability. The Commission's proposal initially cast the net wide, relying on a broad definition of 'consolidated business relationships' to identify business partners and refraining from defining the 'appropriate measures' that would exclude liability, at least in the case of direct partners. The Commission's proposal was more restrictive with regards to indirect partners, for which liability could be excluded in the presence of contractual cascading and compliance verification, unless those measures were reasonably inadequate.[44] As discussed in Section 2, the EP has been sceptical about reliance on contractual cascading, but maintained the possibility for companies to escape liability by demonstrating compliance with the due diligence obligations, unless the due diligence measures were reasonably inappropriate. This approach makes the credibility of supply chain liability dependent on the burden of proof.

The Council's Political Compromise is completely different. As there are no exculpatory provisions, the credibility of supply chain liability depends on the plaintiff's ability to claim a breach of due diligence obligations and damages caused by it. Leaving aside the issue of mass claims, which is left to Member States,[45] the Council has taken quite a restrictive position on at least two conditions for liability, which may undermine effective deterrence. The first is causation: the company's liability is excluded when the damage is caused 'only' by the business partner. The second is the prioritisation of the due diligence actions whenever it is 'not feasible' to address all potential and actual adverse impacts. When an adverse impact on human rights or the environment may not be considered a priority, the company is not in breach of due diligence obligations and is not liable for the damages by business partners.

Not knowing which of these approaches to the liability rule will become final, I shall briefly discuss the major shortcomings of each model.

In the Commission's and the EP's models, the burden of proof is crucial. According to the original proposal, a company could avoid liability for the indirect partners' actions by implementing contractual cascading, that is, requiring contractual partners to request compliance with the code of conduct from their contractual partners and so forth, provided that contractual cascading be accompanied by compliance verification. Because both cascading and compliance verification could be standardised, to prevent box-ticking the Commission added, as a ground for liability, the reasonable inadequacy of these measures to achieve the goals of due diligence. The question is who is to prove the inadequacy. If the burden of proof is on the victim, the liability for actions by indirect partners is effectively muted because the victim does not know or cannot easily learn about the company's procedures. Think of an NGO that wants to protect children being exploited in Africa by some indirect partner of a European manufacturing company. How could such an NGO provide evidence that the company procedures to deal with supply chain partners are inadequate? This rule would work better if the burden of proof was reversed. In this case, box-ticking would no longer be sufficient to avoid liability because the company should demonstrate that its due diligence procedures are reasonably adequate 'to prevent, mitigate, bring to an end or minimise the extent of the adverse impact.'

The EP's version of Art. 22 has a similar structure. It allows the defendant to escape liability by demonstrating compliance with all due diligence obligations, not just contractual cascading. Yet, the company would still be liable if it is unreasonable to expect that the action actually taken is an appropriate measure to achieve the goals of the Directive. Also this text doesn't specify the burden of proof. However, the EP is aware that the victim typically lacks access to evidence and acknowledges that in the amended version of Recital 58 stating that "the company will be responsible for producing evidence to prove it complied with the Directive".[46] This suggests that the defendant should prove the appropriateness of the measures actually taken, after "the

41 Art. 2(f) Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 (Transparency Directive).
42 Art. 3(d) and Art. 6 CSDDD.
43 Art. 2(f)(iv) Transparency Directive.
44 See *supra*, text accompanying notes 18-19.
45 See Recital 58 in the Political Compromise: "[T]his Directive does not regulate who can bring a claim before national courts and under which conditions the civil proceeding can be initiated, therefore this question is left to national law. For example, Member States can decide that it is only the victim who can bring the claim before national courts or that a civil society organisation, trade union or other legal entity can bring the claim on behalf of the victim."
46 Amendment 43 Wolters Report.

claimant provides prima facie elements substantiating the likelihood of the defendant's liability".[47] This language and particularity Recital 58 are significantly different from the original CSDDD proposal. In the Commission's version of Recital 58, the EU legislature basically washed its hands of the burden of proof issue, leaving to national law the question of who should prove the reasonable adequacy of the measures. As I argued in the past,[48] this approach may be even worse than a uniform EU rule as it is likely to trigger a race-to-the-bottom among EU jurisdictions.

The Council's Political Compromise came up with a more structured EU liability rule, though that seems even easier to get around than the original Commission's rule. First of all, the Council reinstates the agnostic EU approach to the burden of proof.[49] Secondly, the new formulation of Art. 22 makes the burden of proof less relevant as it lines up four conditions for liability, which are typically for the plaintiff to show: i) a breach of duty; ii) a company's fault; iii) a damage; and iv) the causal link between the breach and the damage. On causation, Art. 22 now specifies that a company cannot be liable if the damage was caused only by the business partners in the value chain of activities, i.e., a direct or indirect upstream partner or a direct downstream partner of the company. This provision brings into play the doctrine of break of causation chain (*novus actus interveniens*), on which different jurisdictions have different approaches.[50] The relevant question is whether the failure to carry out due diligence is sufficient to cause the damage jointly with the business partner that did it, triggering the joint and several liabilities of the company as is now explicitly provided for.[51] Some jurisdictions will require that the company's failure is a *condicio sine qua non* of the damage by the partner, for others it will be sufficient that it is one of the contributing factors. This will likely create the regulatory arbitrage situation I hinted at before: companies will tend to locate where the causal link between the breach of due diligence and the damage done by the business partner is easier to exclude.

Limiting the scope of liability on the grounds of causation has always been criticised by the law & economics literature because this undermines the tortfeasors' incentive to internalise negative externalities, including contemplating the low-probability consequences of their actions (or inactions). In fact, the doctrine of foreseeability, which limits causation to the damages that can be reasonably foreseen and is tantamount to the break of causal link exception to supply chain liability, reduces the incentive to monitor and is economically justified only when foreseeing remote damages would be too expensive.[52] The Council's approach therefore defies the CSDDD's purpose to foster internalisation of externalities by MNCs to the extent that it undermines the deterrence of supply chain liability and the monitoring incentives stemming from it.

Moreover, the Council's Political Compromise confines the due diligence obligations to adverse impacts that should have been prioritised according to criteria that are currently very vague. Prioritisation is allowed when it is 'not feasible' to address all the adverse impacts.[53] Feasibility, however, is a matter of cost and the legislature is silent on what can be considered too expensive to address. The same criticism applies to actual prioritisation. Assuming that all adverse impacts can be ranked based on their severity and likelihood, as required by the Council's text, where should one draw the line above which the impacts are 'significant' and must be addressed 'in a reasonable time'? As a result, companies who are sued for breach of due diligence obligations will have an additional way to escape liability by arguing that the damage occurred in parts of their supply chains that couldn't be prioritised.[54]

6. Conclusion

Corporations have been using limited liability to avoid tort liability and externalise damages to society, as confirmed by economic theory and empirical evidence. In the context of environmental and human rights protection, the CSDDD proposal could potently ameliorate this situation by establishing civil liability for failure to carry out due diligence in the relationship with subsidiaries and business partners in the supply chain. Facing supply chain liability, companies could not get away with environmental harm or human rights violations simply by using subsidiaries or outsourcing harmful activities to remote business partners.

Unfortunately, the analysis of the CSDDD proposals currently on the table of EU institutions reveals important loopholes in the civil liability rule, which undermine its effectiveness. Companies seem to be able to evade liability either by choosing a favourable regime of the burden of proof, or by making it more difficult for victims to claim damage causation by due diligence failure through the choice of incorporation or the design of complex supply chains.

47 Art. 22 CSDDD, Amendment 198 Wolters Report.

48 Alessio M. Pacces, 'Supply Chain Liability in the Corporate Sustainability Due Diligence Directive Proposal', *ECGI Blog*, 12 April 2022, https://www.ecgi.global/blog/supply-chain-liability-corporate-sustainability-due-diligence-directive-proposal.

49 See Recital 58 in the Political Compromise: "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."

50 Penelope A. Bergkamp, 'Models of Corporate Supply Chain Liability', *Jura Falconis*, 55(2), 2018, 185.

51 Art. 22(3) in the Political Compromise.

52 Omri Ben-Shahar, 'Causation and foreseeability', in: Michael Faure, *Tort Law & Economics*, 2009, Edward Elgar, 100-101.

53 Art. 6a in the Political Compromise.

54 More along these lines could be said about the criteria laid down in the Council's text to determine whether the due diligence measures are 'appropriate', which indirectly define the fault requirement of the supply chain liability. I leave this discussion for another day. See Art. 7(1) and 8(1) in the Political Compromise.

Mieke Olaerts[1]

Corporate Sustainability and the Duty of Care of Directors

Ondernemingsrecht 2023/38

- **Article 25 of the proposed CSDDD can have a signalling function and is in line with developments at national as well as EU level.**
- **The proposed provision does however lead to a need for further clarification when applied to company groups this is due to the fact that it is combined in a proposed directive on due diligence.**
- **It may be advised to align the scope of application of the duty with the scope of the CSRD.**

Article 25 of the proposed CSDDD requires directors to take into account the consequences of their decisions for sustainability matters. While the use of directors' duties as a tool to promote sustainability has been proposed in the past, it has also been criticized. This debate will be explored in this article. It will be argued that even though the introduction of sustainability into directors' duties will not solve all problems, it should not be overlooked as one of the tools to enhance long-term sustainable decision-making. It is not new since it builds upon the obligations contained in the recently adopted CSRD. Therefore, making this explicit in the duty of the board of directors does not change the content of their task. The fear of interference with directors' duties at the national level should furthermore not be overstated as Article 25 leaves considerable freedom to Member States with regard to the implementation of this duty.

1. Introduction

The proposed directive on corporate sustainability due diligence (hereinafter proposal for CSDDD)[2] aims to ensure that companies 'contribute to sustainable development and the sustainable transition of economies and societies' by putting in place due diligence obligations.[3] Next to these due diligence obligations, the proposed directive also contains several provisions related to sustainable corporate governance in a broader sense. Article 25 is one of those provisions as it sets out a duty of care for the board of directors, requiring directors to take into account the consequences of their decisions for sustainability matters.

The idea of using directors' duties to enhance sustainability was already suggested earlier and has been criticized from various angles.[4] The differences in thinking about directors' duties and the approach to sustainability suggest that we may still be far away from finding a true *ius commune*. It remains to be seen whether the proposed Article 25 will eventually see the light of day in a final version of the directive as it does not reappear in the Council's compromise text of the proposed directive. Nevertheless, the concept of using directors' duties in the quest for sustainable decision-making is an interesting one to explore as this tool is currently also used at the national level in at least some of the EU Member States.

This article focuses on the duty of directors under Article 25 of the proposed directive and the general idea of introducing sustainability as part of directors' duty of care at the European level. The aim is to understand the background of the proposed provision and assess its potential for harmonization and instigating a 'revolutionary' change in the corporate landscape of the EU as well as assessing the criticism.[5] The article starts with an explanation of the duty of care envisioned in Article 25 and a brief discussion of the lead-up to this provision in the draft directive to better understand the background of the proposal (section 2). The debate regarding the introduction of sustainability as part of directors' duties will be explored in section 3. It will be argued that even though the introduction of sustainability into directors' duties will not solve all problems, it should not be overlooked as one of the tools to enhance long-term sustainable decision-making as it sends a signal raising awareness of the need to take sustainability matters into account. It is also not entirely new as it builds upon the obligations contained in the recently adopted Corporate Sustainability Directive (CSRD) requiring directors of companies of a certain size to take sustainability matters into account when defining the corporate strategy. Therefore, making this explicit in the duty of the board

1 Mieke Olaerts is Professor of Comparative and National Company Law at Maastricht University and Elverding Chair on Sustainable Business, Culture and Corporate Regulation. The Elverding chair is sponsored by ING, Q-Park, DNB, DSM and Broadview.
2 Proposal for a Directive of the European Parliament and the Council on Corporate Sustainable Due Diligence and amending Directive (EU) 2019/1937, COM(2022) 71 final.
3 Recital 14 of the preamble of the proposed CSDDD.
4 See for example several blogs on this subject such as The ECLE Group, 'The proposed Due Diligence Directive should not cover the general duty of care of directors', ECGI Blog August 2022; J.L. Hanssen, 'Unsustainbale Sustainability', ECGI Blog April 2022; E. Lidman, 'The role of corporate governance in sustainability and why the Commission's CSDDD proposal might do more harm than good', ECGI Blog April 2022; S. Thomson, 'Sustainable Corporate Governance and the Road to Stagnation', April 2022. These blogs are available at https://ecgi.global/blog-theme/corporate-sustainability-due-diligence.
5 See for authors in favour of this duty B. Sjåfjell & J. Mähönen, 'Corporate Purpose and the EU Corporate Sustainability Due Diligence Proposal', ECGI Blog April 2022.

of directors in essence does not change the content of their task. It will also be argued that the fear of interference with directors' duties at the national level should not be overstated as Article 25 leaves considerable freedom to Member States with regard to the implementation of this duty. The main findings will be highlighted in the conclusion (section 4).

2. Background and Content of the Proposed Duty for Directors

2.1 *Background of the Proposed Duty*

Article 25 of the proposed directive requires Member States to ensure that, '*when fulfilling their duty to act in the best interest of the company, directors (…) 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*'.[6]

The second paragraph furthermore states that national laws, regulations and administrative provisions providing for a breach of directors' duties should also apply to this provision.[7]

The use of directors' duties as a tool to enhance long-term decision-making for a more sustainable future has been suggested several times over the years both in working groups and reports at the EU level as well as in legal scholarship.[8] In 2011 the Reflection group on the Future of EU Company Law proposed the adoption of an EU directive or recommendation requiring national legislators to allow companies in the EU to put in their articles of association that the overall goal of the company is the long term viability and continuity of the enterprise including the option to explicitly state in the articles of association that the board manages the company primarily in the company interest. This was suggested in an attempt to enhance long-term decision-making as it would allow the board to choose for the long-term interest of the company acknowledging that this could go against shareholders' short-term interest.[9] The idea of harmonising directors' duties to not only enhance long term decision-making but also sustainability was later on developed further. The High-level group on sustainable finance for example suggested in 2018 to embed sustainability in the duties of directors of financial institutions.[10] This idea was taken on by the European Commission in its subsequent 2018 action plan.[11] The idea that corporate governance should be adjusted to encompass sustainability was also mentioned in the European Green deal[12] and furthermore appeared in the EY study on directors' duties and sustainable corporate governance published in 2020.[13] The latter study concluded that Directors' duties and the company's interest are interpreted narrowly and tend to favour short-term shareholder value maximisation. One of the proposals in the study was therefore to design a uniform interpretation of directors' duties and the company's interest at the EU level. Another outcome of this study was to propose the adoption of new EU-binding rules to strengthen the enforcement of the directors' duty to act in the interest of the company. The idea to harmonise directors' duties at the EU level was also proposed by the researchers of the SMART project as a means to fight the dominant paradigm of shareholder primacy.[14] These developments and proposals at the EU level do not stand on their own. As mentioned in the introduction, also in some of the EU Member States the idea of integrating sustainability aspects into the task of the board has been explored.

The European Green Deal and the abovementioned EY study led to the European Commission's consultation on the sustainable corporate governance initiative in 2020. With its sustainability initiative, the Commission consulted more broadly on areas related to corporate governance. This concerned, amongst others, topics such as directors' remuneration, stakeholder engagement, regulating share buybacks and enhancing sustainability expertise on com-

6 This duty would be applicable to companies falling within the ambit of the directive as defined in Article 2 of the proposed directive meaning, in short, companies with more than 500 employees and a net turnover of more than 150 million euro in the last financial year or companies with more than 250 employees and a net turnover of more than 40 million operating in one of the high impact sectors as defined by the directive or companies from third countries that have a net turnover of at least 150 million in the union or between 40 and 150 million but operating in one of the high impact sectors.

7 Article 25 section 2 of the proposed CSDDD.

8 See in this respect for example the work by Beate Sjåfjell as part of the SMART project. B. Sjåfjell, 'Reforming EU Company Law to Secure the Future of European Business', *ECFR* 2/2021, p. 190-217.

9 Report of the Reflection Group on the Future of EU Company Law, April 2011, p. 37-38 available on ssrn https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1851654.

10 See the report of the EU High Level Expert Group on Sustainable Finance, 2018 available at https://finance.ec.europa.eu/system/files/2018-01/180131-sustainable-finance-final-report_en.pdf.

11 Communication from the Commission on the Action Plan: Financing Sustainable Growth COM(2018) 97 final, action 10.

12 Communication from the Commission on the European Green Deal, COM(2019) 640 final, p. 17. See about this background and all these initiatives F. Agostini & M. Corgatelli, 'Article 25 of the Proposal for a Directive on Corporate Sustainability Due Diligence: Enlightened Shareholder Value or Pluralist Approach?', *ECL* 19, no. 4 (2022): 92-99 and B. Sjåfjell, 'Reforming EU Company Law to Secure the Future of European Business', *ECFR* 2/2021, p. 190-217.

13 EY Study on directors' duties and sustainable corporate governance, Final Report July 2020 available at https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en.

14 SMART stands for a group of academics working on the project team of Sustainable Market Actors for Responsible Trade. The report can be found on ssrn B. Sjåfjell et al., 'Securing the future of European business: SMART reform proposals', *University of Oslo Faculty of Law Legal Studies Research Paper Series*, No. 2020-11, p. 57 and further. According to their reform proposal there should be a general duty for the board of directors of undertakings with limited liability established in the EU to promote the interest of the undertaking. This was combined with a proposal to adopt at the EU level an overarching purpose for undertakings according to which they have to create sustainable value within planetary boundaries.

pany boards as well as directors' duties.[15] Meanwhile the European Parliament also called for action with regard to directors' duties as well as in the area of due diligence.[16] Initially it was expected that the sustainable corporate governance aspects on the one hand and the due diligence obligations on the other would lead to two separate legislative initiatives. However, some of the ideas on sustainable corporate governance have now been combined with due diligence obligations in the proposed CSDDD.[17] The incorporation of these issues of sustainable corporate governance divide the proposed directive into two separate parts. The articles related to sustainable corporate governance seem to be the more controversial part of the proposed directive compared to the due diligence obligations.[18]

2.2 *Scope and Content of the Duty of Care*

If adopted, Article 25 will be applicable to directors of EU-incorporated companies that fall within the scope of the directive. Even though several of the CSDDD provisions relating to due diligence are also applicable to companies incorporated outside of the EU but with activities in EU Member States, this is not the case for the general duty of care envisaged in Article 25. Therefore, this duty only applies to boards of EU-incorporated companies that fall within the scope of the directive.[19]

Article 25 will furthermore apply to a wide range of not only statutory directors but also members of top management such as the members of the executive committee. This is due to the definition used for the term director under the proposed directive. The term 'director' refers to members of the management board as well as members of the supervisory body, the CEO and where applicable the deputy CEO in case they are not a member of the administrative, management or supervisory body of the company. Furthermore, also other persons who perform functions similar to those performed by the people mentioned in the previous sentence can be included in the definition of a director.[20]

One of the reasons for criticism on Article 25 of the proposed CSDDD is that it is unnecessary in a directive on due diligence obligations.[21] This was also pointed out by the Regulatory Scrutiny Board which issued two negative opinions on earlier drafts of the proposal.[22] In order to address this issue the Commission explained, in response to that negative opinion, that Directors' duties were significantly reduced in the new version of the proposal.[23] The preamble of the proposed CSDDD now states that the aim of Article 25 is to ensure that the general duty of directors is applied in a coherent way, consistent with the due diligence obligations imposed by the proposed directive and that directors take sustainability matters into consideration in their overall decision-making in order to create a level playing field at the EU level.[24] The narrowing down of directors' duties seems to suggest that the proposed article now mainly refers to the need to put in place due diligence requirements. However, the preamble and the text of Article 25 suggest a duty of a more general nature.[25] The CSDDD already contains a specific duty for directors to set up due diligence procedures in Article 26. The latter article stipulates that Member States should ensure that directors are responsible for putting in place and overseeing the due diligence actions required by the directive and that the directors take steps to adapt the corporate strategy to take into account the actual and potential adverse

15 See the summary report of the public consultation regarding the sustainable corporate governance initiative https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance_en.

16 See European Parliament resolution of 17 December 2020 on sustainable corporate governance (2020/2137(INI)) and European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)).

17 This was somewhat surprisingly see also J.E.S. Hamster, 'De verwachte richtlijn duurzame corporate governance: verantwoord ondernemen moet hoog op de bestuursagenda', *MvO* 2021, nr. 7-8, p. 271. Some other topics of the sustainable corporate governance initiative have been taken up in other actions. Enhancing sustainability expertise on boards is for example a topic taken on in the proposed Corporate Sustainability Reporting Directive (CSRD). Article 29a of the proposed CSRD requires companies to provide 'a description of the role of the administrative, management and supervisory bodies with regard to sustainability matters, and of their expertise and skills in relation to fulfilling that role or the access such bodies have to such expertise and skills;'. The Council gave its final approval to this proposed directive in November 2022. https://www.consilium.europa.eu/en/press/press-releases/2022/11/28/council-gives-final-green-light-to-corporate-sustainability-reporting-directive/.

18 J.L. Hansen a.o., 'Response to the Study on Directors' Duties and Sustainable Corporate Governance by Nordic Company Law Scholars', *University of Copenhagen Faculty of Law Legal Studies Research Paper Series*, No. 2020-100, available at: https://ssrn.com/abstract=37.

19 S.B. Garcia Nelen, 'Het voorstel voor een Europese Corporate Sustainability Due Diligence-richtlijn', *Ondernemingsrecht* 2022/41.

20 Article 3(o) of the CSDDD.

21 ECGI Blog available at https://ecgi.global/blog/proposed-due-diligence-directive-should-not-cover-general-duty-care-directors; J.L. Hansen a.o., 'Response to the Study on Directors' Duties and Sustainable Corporate Governance by Nordic Company Law Scholars', *University of Copenhagen Faculty of Law Legal Studies Research Paper Series*, No. 2020-100, available at: https://ssrn.com/abstract=37.

22 According to the Regulatory Scrutiny Board the impact assessment was not clear about the need to regulate directors' duties on top of due diligence requirements. Regulatory Scrutiny Board Opinion of 16 November 2021, SEC(2022) 95.

23 Briefing Initial Appraisal of a European Commission Impact Assessment, October 2022, available at https://www.europarl.europa.eu/RegData/etudes/BRIE/2022/734677/EPRS_BRI(2022)734677_EN.pdf. The proposal previously contained a 'broader duty to manage risks to the company related to stakeholders and their dependencies, as well as the broader duty to include the management of sustainability risks to the company in the corporate strategy' also the 'duty to set up and oversee the implementation of processes related to the management of sustainability risks to the company, and the mandatory adoption and disclosure of science-based targets were not retained (…).' See Commission Staff Working Document Follow-up to the second opinion of the Regulatory Scrutiny Board Accompanying the document Proposal for a Directive of the European Parliament and the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, SWD(2022) 39 final, p. 8.

24 Recital 63 of the proposed CSDDD. See also p. 11 of the Commission's proposal for a directive.

25 F. Agostini & M. Corgatelli, 'Article 25 of the Proposal for a Directive on Corporate Sustainability Due Diligence: Enlightened Shareholder Value or Pluralist Approach?', *ECL* 19, no. 4 (2022): 97.

impacts identified in the due diligence process. The interrelation between the two articles is not clear from the outset. One potential interpretation is that having in place a proper due diligence system along the lines of the proposed directive is a factor to take into account when considering whether or not a director has fulfilled the general duty of care envisioned in Article 25 of the proposed directive. This interpretation follows the lines of the proposals made in the SMART project where sustainability due diligence is seen as a defense mechanism in case wrongdoings took place despite the best efforts made by the company to avoid these wrongdoings.[26] Article 25 in that sense reiterates what is already enshrined in Article 26 of the proposed CSDDD and once more makes the role of the board explicit.

As mentioned in the introduction, it is questionable whether the proposed duty will ever be adopted at the European level as Article 25 and 26 have both been deleted in the Councils Compromise text. Nevertheless, it remains interesting to assess the use of directors' duties as a tool to enhance long term sustainable decision-making.

3. Sustainability and Directors' Duties

3.1 *Sustainability as an Element of the Task of the Board*

As mentioned in section 2, the incorporation of sustainability into directors' duties was already proposed as a solution for short-termism in the EY report[27] which received heavy criticism.[28] One of the arguments against introducing such a duty is that it will not have much effect[29] and may do more harm than good. Some authors for example point to the fact that most EU Member States already define directors' duties to go beyond shareholder primacy but that this has apparently not solved the problem.[30] Opponents furthermore argue that introducing too many rules may lead to companies being less willing to take risks in order to achieve sustainable solutions for fear of legal claims while judges are unable to decide with hindsight whether a decision or an action was indeed socially responsible.[31] Another argument is that changing directors' duties in this way will entrench management as it decreases accountability towards shareholders.[32] Several of these arguments reiterate the differences in views underlying the stakeholder versus shareholder debate. The fact that a stakeholder model reduces board accountability is for example an argument that is often used by proponents of the shareholder model.[33]

Despite the criticism, the idea of requiring directors to take into account the consequences of the company's actions for sustainability issues such as human rights and the environment is in my opinion an interesting one. Making this explicit can create more awareness within company boards and leads to the need to incorporate sustainability aspects in the day-to-day decision-making, the discussions with the supervisory board etc. Corporate leadership and therefore the role of the board is key to embedding sustainability. The actions of top management have an important effect on (sustainable) decision-making and behaviour throughout the company.[34] It has to be admitted that it remains difficult to substantiate that changing directors' duties in this way will indeed contribute to long-term sustainable decision-making. It should of course not be the only way to emphasize the importance of the role of the board. Other tools to enhance long-term sustainable decision-making should also not be overlooked. Intrinsic motivation, the role of employees, setting

26 B. Sjåfjell a.o., 'Securing the Future of European Business: SMART Reform Proposals', *Nordic & European Company law LSN Research Paper Series*, No. 20-08, p. 58.

27 EY Study on directors' duties and sustainable corporate governance, Final Report July 2020 available at https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en.

28 The EY report led to a lot of criticism for example with regard to the method on which the finding of short-termism was based. See for example the reaction of European Company Law Experts available at https://europeancompanylawexperts.wordpress.com/publications/european-commission-study-on-directors-duties-and-sustainable-corporate-governance/; Roe e.a., 'The EY Sustainable Corporate Governance Report's Major Flaws: Discussion and Analysis', 2020, https://ec.europa.eu/info/law/better-regulation/have-yoursay/initiatives/12548-Sustainable-corporate-governance/F594640; M.J. Roe a.o., 'The European Commission's Sustainable Corporate Governance Report: A Critique', *Yale Journal on Regulation Bulletin* 2021, Vol. 38:133-153. See for a broader overview B.J. de Jong, 'Duurzame corporate governance: Europese en Nederlandse ontwikkelingen', *Ondernemingsrecht* 2021/33.

29 M.J. Roe a.o., 'The European Commission's Sustainable Corporate Governance Report: A Critique', *Yale Journal on Regulation Bulletin* 2021, Vol. 38:133-153.

30 M.J. Roe a.o., 'The European Commission's Sustainable Corporate Governance Report: A Critique', *Yale Journal on Regulation Bulletin* 2021, Vol. 38:133-153.

31 H.J. de Kluiver, 'Over de verantwoordelijke onderneming. Naar een Paradise by the dashboard light?', *Ondernemingsrecht* 2020/126; M.J. Roe a.o., 'The European Commission's Sustainable Corporate Governance Report: A Critique', *Yale Journal on Regulation Bulletin* 2021, Vol. 38:133-153.

32 E. Lidman, 'The role of corporate governance in sustainability and why the Commission's CSDDD proposal might do more harm than good', ECGI Blog April 2022. E. Lidman & J.L. Hansen Response to the Proposed Corporate Sustainability Due Diligence Directive by Nordic and Baltic Company Law Scholars, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/07/response-proposed-corporate-sustainability-due-diligence-directive; G.D. Mosco & R. Felicetti, 'The EU's Corporate Sustainability Due Diligence Directive: An Excessively Diligent Proposal', available at https://blogs.law.ox.ac.uk/blog-post/2022/09/eus-corporate-sustainability-due-diligence-directive-excessively-diligent.

33 H. Hansmann & R. Kraakman, 'The End of History for Corporate Law', 2000 Harvard Law School John M. Olin Center for Law, Economics, and Business Discussion Paper No. 280 available at ssrn.

34 L. Guiso, P. Sapienza, & L. Zingales, 'The Value of Corporate Culture', *Journal of Financial Economics* 2015, 117(1): 60-76; J.L. Walls & P. Berrone, 'The Power of One to Make a Difference: How Informal and Formal CEO Power Affect Environmental Sustainability.' *Journal of Business Ethics* 2017, 145: 293-308. See about this R. Bauer, T. Bauer, M. Olaerts & C. van Aartsen, *Eumedion Report Sustainability embedding practices in Dutch listed companies*, October 2021, available at https://www.eumedion.nl/clientdata/215/media/clientimages/Eumedion-report-final-version-for-publication.pdf?v=211026081556.

the right culture, remuneration, board composition and so many other tools can form part of this complicated puzzle striving for sustainable decision-making.[35] However, introducing sustainability as part of the task of the board does make more clear what is expect from boards in terms of the outer boundaries of corporate decisions. If we want to take on board corporate law as one of the tools for providing potential solutions, then looking at the role of the board of directors is a logical first step. Moreover, taking up this duty at the European level can serve an important signalling function making explicit what is expected of EU incorporated companies and their main decision-makers. After all, the sustainability problems our society is facing are undeniable and are not restricted to the borders of individual Member States.[36] Furthermore, there are several other reasons why the resistance against the incorporation of sustainability as part of the duty of care should in my opinion be nuanced.

First of all, we seem to have reached a point of no return at the EU level as recent legislative changes already require the boards of companies of a certain size to take sustainability matters into account when setting the corporate strategy. In essence, Article 25 does not change the task of directors but merely makes explicit in an overarching duty what is already expected from the board, or what will soon be expected once legislative and regulatory changes take effect. After all, the recently adopted CSRD[37] already requires companies that fall within the scope of that directive to report on the plans of the undertaking on how its business model and strategy are compatible with the transition to a sustainable economy and with limiting global warming in line with the Paris Agreement and the objective of achieving climate neutrality by 2050. These boards are also required to report on how the business model and strategy take the undertakings stakeholders and its impact on sustainability matters into account.[38] It has been argued in the literature that the provisions of the CSRD are further reaching than merely laying down reporting requirements as they contain an obligation for companies to have a sustainability strategy with specific targets.[39] Against this background, formulating the need to take sustainability matters into account as part of directors' duties seems to be only a small next step. In order to make the proposed Article 25 more acceptable, it may however be advised to align its scope of application with that of the CSRD.

Secondly, Article 25 coincides with developments at the national level in France, the Netherlands and Germany. These developments also provide for a push in the direction of requiring directors to take sustainability matters into account when setting out the corporate strategy. The French legislature for example recently introduced changes to its company law resulting in the introduction of a plurality of interests to be taken into account by the directors. Article L225-64 applicable to French public companies (SA's) stipulates with regard to the role of board of directors: 'Il détermine les orientations de l'activité de la société et veille à leur mise en œuvre, conformément à son intérêt social, en considérant les enjeux sociaux, environnementaux, culturels et sportifs de son activité.' The provision, in short, requires the board to fulfill its duties in the interest of the company while taking into account a number of other issues such as the social, environmental and cultural consequences of its activities. Even though Dutch law already uses a stakeholder model when interpreting directors' duties, changing directors' duties in this respect seemed to be a bridge too far for the Dutch legisla-

35 See for more tools for embedding sustainability R. Bauer, T. Bauer, M. Olaerts & C. van Aartsen, ***Eumedion Report Sustainability embedding practices in Dutch listed companies***, October 2021, available at https://www.eumedion.nl/clientdata/215/media/clientimages/Eumedion-report-final-version-for-publication.pdf?v=211026081556.

36 Impact assessment report SWD(2022) 42 final, section 3. See also F. Agostini & M. Corgatelli, 'Article 25 of the Proposal for a Directive on Corporate Sustainability Due Diligence: Enlightened Shareholder Value or Pluralist Approach?', *ECL* 19, no. 4 (2022):97.

37 The CSRD entered into force on 5 January 2023 Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

38 Article 19a-2 sub iii and iv of Directive 2013/43/EU as amended by the CSRD.

39 L.K. van Dijk & J.B.S. Hijink, 'Finalisering van de Europese CSRD: een mijlpaal voor duurzaamheidsverslaggeving met grote impact op het ondernemingsrecht vanaf 2025', *Ondernemingsrecht* 2022/87. It has to be admitted that the preamble of the CSRD can still lead to some discussion as to whether the CSRD actually obliges companies and their boards to make ambitious sustainability plans. Recital 30 for example mentions that companies 'should also be required to disclose **any plans they may have** [emphasis added MO] to ensure that their business model and strategy are compatible with the transition to a sustainable economy and with the objectives of limiting global warming to 1,5 °C in line with the Paris Agreement and achieving climate neutrality by 2050'. This seems to suggest that there is some freedom with regard to having these plans. Recital 36 furthermore seems to allow companies some freedom of choice with regard to which policies they would like to pursue as it states that 'Article 19a(1) and Article 29a(1) of Directive 2013/34/EU require undertakings to provide a clear and reasoned explanation for not pursuing policies in relation to one or more of the matters listed in those Articles, where the undertaking does not do so.' However, although recitals 30 and 36 of the preamble of the CSRD are ambiguous in several aspects and regardless of how detailed the provision of the CSRD are, the CSRD does in any case require the board to take sustainability issues into account and to at least as a minimum explain why certain issues were regarded as relevant and why other issues were not which means that they will have to be considered by the board.

ture.[40] However, at the end of 2022 the Dutch corporate governance code was revised emphasising the role of the board of directors in setting out a sustainable long-term company strategy. The Dutch corporate governance code 2022 now requires the board of directors of listed companies to take into account the consequences of the company's activities on people and the environment.[41] A comparable approach is used in the German Corporate Governance Code. Principle 1 of the code states that the management board is responsible for managing the enterprise in its own best interest. After its revision in 2022 of the German Corporate Governance Code recommendation A.1 clarifies that: 'The Management Board shall systematically identify and assess the risks and opportunities associated with social and environmental factors, as well as the ecological and social impacts of the enterprise's activities. In addition to long-term economic objectives, the corporate strategy shall also give appropriate consideration to ecological and social objectives. (…).'

Article 25 CSDDD aims to build on these developments by using the concept of the company interest. The proposal takes as point of departure that based on national law, directors are already obliged to perform their duties with a view to promoting the interest of the company. As mentioned above, the idea to require directors to act in the interest of the company was already proposed by the Reflection group on the Future of EU Company Law in 2011. Back then, the idea was that companies should have the freedom to opt for this in their articles of association. Apparently, national law has developed in the meantime, as the Commission in the CSDDD proposal seems to assume that national law already requires directors to act in the company interest without the need for a provision to this effect in the articles of association.[42]

Upon closer examination, the idea behind the proposal is therefore not so much to harmonise directors' duties but rather to restate what is already applicable on the basis of national law (serving the company interest)[43] and to provide further clarification in the sense that when fulfilling the general duty to act in the interest of the company, the directors should take into account sustainability matters such as human rights, climate change and environmental consequences of the company's operations, the latter coincides with the requirements under the CSRD.[44] The preamble explicitly states that: 'Such clarification does not require changing existing national corporate structures.'[45] Whether or not this is the case, will be further discussed in the next section.

3.2 *Light Form of Harmonization: The Company Interest*

If adopted, Article 25 of the proposed CSDDD will most probably lead to a form of 'light harmonisation'. The aim of the directive is not so much to harmonise directors' duties. The difficulty with setting out standards for directors' duties at the EU level is that this interferes with national directors' duties which are often the result of a delicate built-up system based on company law provisions in combination with case law developments. Given the problematic track record of earlier harmonisation attempts, the Commission's approach of trying to build on what already exists at the national level does indeed seem to be the most promising avenue.[46] A similar type of harmonisation was proposed by the already mentioned SMART project. The proposal launched by this initiative was also to clarify what is seen by the researchers as 'well-established company law' namely the duty to serve the company interest but which according to them has become 'clouded' by shareholder primacy.[47] Rather than proposing a harmonisation of what serving the company interest entails, they also proposed to delineate the boundaries within which the board should operate when promoting the interest of the company. However, as mentioned earlier, Article 25 does not resurface in the Council's compromise text of the CSDDD. The reason for deleting this provision is according to the Council: "(…) the strong concerns expressed by Member States that considered Article 25 to be an inappropriate interference with national provisions regarding

40 25 professors proposed explicitly incorporating in the law that the board of directors has the duty to ensure that the company conducts its business in a responsible manner see J.W. Winter a.o., 'Naar een zorgplicht voor bestuurders en commissarissen tot verantwoordelijke deelname aan het maatschappelijk verkeer', *Ondernemingsrecht* 2020/86 and *Ondernemingsrecht* 2021/6. See for criticism amongst others H.J. de Kluiver, 'Over de verantwoordelijke onderneming. Naar een Paradise by the dashboard light?', *Ondernemingsrecht* 2020/126; W.A. Westenbroek, 'Een maatschappelijke verantwoordelijkheid voor ondernemingen en (bange?) bestuurders of coronawetenschap in crisistijd?', *Ondernemingsrecht* 2021/3; A.J. Kaarls, 'Vage praatjes vullen geen gaatjes', *Ondernemingsrecht* 2021/4; G.N.H. Kemperink, ***De positie van de kapitaalvennootschap bij overnames en bij strategische samenwerking in geopolitieke context*** (preadvies Vereeniging Handelsrecht), Zutphen: Uitgeverij Paris, 2020, p. 54 e.v. See about this discussion B.J. de Jong, 'Duurzame corporate governance: Europese en Nederlandse ontwikkelingen', *Ondernemingsrecht* 2021/33. An advisory group on modernizing Dutch law for public companies advised against this proposal. See *Kamerstukken II* 2020/21, 29752, 14, p. 3 and p. 6-7.

41 Principle 1.1 of the revised Corporate Governance Code 2022. This revised version still has to be appointed by the Dutch legislator as the official Dutch corporate governance code applicable to listed companies.

42 According to recital 63 of the preamble of the proposed CSDDD under all national laws within the Member States directors owe a duty of care to the company.

43 There are also commentators who argue that the concept of the company interest does not exist everywhere see The ECLE Group, 'The proposed Due Diligence Directive should not cover the general duty of care of directors', ECGI Blog August 2022.

44 Commission's proposal for a directive, p. 22.

45 Recital 63 of the preamble of the Commission's proposal for the CSDDD.

46 Attempts to harmonize rules related to the functioning of the board of directors are often controversial, hardly ever leading to a successful outcome. One can recall for example the failed attempt for a fifth company law directive on management structures of companies.

47 B. Sjåfjell a.o., 'Securing the Future of European Business: SMART Reform Proposals', *Nordic & European Company law LSN Research Paper Series*, No. 20-08, p. 57.

directors' duty of care, and potentially undermining directors' duty to act in the best interest of the company (…)."[48]

The risk of inappropriate interference should, in my opinion, be nuanced for the following reasons. Article 25 does not specify what the interest of the company should entail nor does it give guidance as to how the different interests involved should be balanced. This was in fact one of the points of critique mentioned by the Regulatory Scrutiny Board which stated in its second negative impact assessment that: 'The description of the directors' duties should clarify how directors need to incorporate conflicting interests of stakeholders and sustainability aspects. It should clarify whether or not there is a long-term interest of the company that could supersede particular interests of stakeholders or beneficiaries or particular sustainability considerations.'[49]

The latter is in my opinion however very difficult to do. National law rarely defines what the company interest entails or what interests should be included.[50] On the contrary, national law generally provides the board of directors with a lot of discretion to take business decisions and balance the various interest involved. Prescribing ex ante how this should be done or which interests can prevail, is complicated, especially at a European level. What serving the company interest entails can and will be interpreted differently in different Member States. In that sense Article 25 leaves a lot of room for national law to fill in what the duty entails and how directors can be held accountable in case of not fulfilling this duty. Some Member States for example emphasise the economic interest of the company leaning more towards a shareholder model while others make use of a more pluralistic approach in which the interest of several stakeholders have to be balanced.[51] The UK for example, even though no longer part of the EU, is often used as the leading example of a legal system that attempts to define the interest of the company or at least the interests that the directors should take into account in more detail. Section 172 of the UK Companies Act 2006 requires a director to act 'in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to— (a) the likely consequences of any decision in the long term, (b) the interests of the company's employees, (c) the need to foster the company's business relationships with suppliers, customers and others, (d) the impact of the company's operations on the community and the environment, (e) the desirability of the company maintaining a reputation for high standards of business conduct, and (f) the need to act fairly as between members of the company.' This enlightened shareholder approach focuses on the duty of the board of directors to promote the success of the company primarily in the interest of the shareholders. It, therefore, provides for a certain ranking in the interests involved in the sense that the interests of the shareholders are dominant but have to be set off against a number of other interests mentioned in section 172 of the UK Companies Act 2006.[52] The Netherlands is often mentioned as an example of a system in which the company interest represents a pluralist approach.[53] Dutch law recognises that the board should serve the interest of the company and the enterprise connected to it[54] and uses a stakeholder model to define what this interest entails. Serving the interest of the company requires the board of directors to serve several interests involved in promoting the sustainable continuation of the company and the enterprise connected to it. What this entails, depends on the specific circumstances at hand. There is a debate amongst corporate scholars on whether or not societal interest can form part of the company interest that the directors have to serve.[55] There are circumstances in which societal interests will inherently be part of the interest of the company, this will, for example, be the case if the company's activities have a direct influence on a specific societal interest. However, it is generally accepted that next to that there may also be a duty of care for the company to take into account the interest of stakeholders that are affected by the activities of the company into account. Disregarding this duty may result in a tort claim against the company.[56] Given the latest changes to the Dutch corporate governance code at the end of 2022, the board of listed companies will already be required to ensure long-term sustainable decision-making and in doing so to take into account the effects of the company's activities on people and the environment.

48 Compromise Text of the Council of 30 November 2022, 2022/0051(COD), p. 10, nr. 31.

49 Regulatory Scrutiny Board opinion on Proposal for a Directive of the European Parliament and of the Council on Sustainable Corporate Due Diligence and amending Directive (EU) 2019/1937, SEC(2022) 95, p. 3, nr. 9.

50 B. Sjåfjell, 'Reforming EU Company Law to Secure the Future of European Business', *ECFR* 2/2021, p. 205; J.W. Winter, 'Towards a Duty of Societal Responsibility of the Board', *ECL* 17, no. 5 (2020):196.

51 B. Sjåfjell a.o., 'Securing the Future of European Business: SMART Reform Proposals', *Nordic & European Company law LSN Research Paper Series*, No. 20-08, p. 58.

52 F. Agostini & M. Corgatelli, 'Article 25 of the Proposal for a Directive on Corporate Sustainability Due Diligence: Enlightened Shareholder Value or Pluralist Approach?', *ECL* 19, no. 4 (2022): 94; J.W. Winter, 'Towards a Duty of Societal Responsibility of the Board', *ECL* 17, no. 5 (2020): 192-200.

53 In this view the interest of stakeholders are not ranked in a certain hierarchy and all have to be taken into account on their own merits see F. Agostini & M. Corgatelli, 'Article 25 of the Proposal for a Directive on Corporate Sustainability Due Diligence: Enlightened Shareholder Value or Pluralist Approach?', *ECL* 19, no. 4 (2022):94.

54 Article 2:129/239-5 Dutch Civil Code. What this entails is further defined by case law more specifically in the Cancun case the Dutch Supreme Court ruled that if the company has an enterprise connected to it, serving the interest of the company entails serving the promoting the lasting success of the enterprise. HR 4 April 2014, ECLI:NL:HR:2014:799, *JOR* 2014/290.

55 B.J. de Jong, 'Duurzame corporate governance: Europese en Nederlandse ontwikkelingen', *Ondernemingsrecht* 2021/33; J.E.S. Hamster, 'Het voorstel van de Europese Commissie voor een richtlijn inzake passende zorgvuldigheid op het gebied van duurzaamheid: een kritische verkenning', *MvO* 2022, nr. 5-6, p. 158.

56 S.B. Garcia Nelen, 'Het voorstel voor een Europese Corporate Sustainability Due Diligence-richtlijn', *Ondernemingsrecht* 2022/41.

Given the above, implementing Article 25 CSDDD in a country such as the Netherlands will most likely not lead to a revolutionary change.[57] This may be different for Member States that make use of a more shareholder-oriented system. However, also there the proposed provision seems to leave a considerable amount of leeway regarding how the different interests involved should be balanced. In a more shareholder-oriented system the implementation of Article 25 will indeed mean that sustainability matters will have to be taken into account and may have to be given priority over the interests of shareholders. However, the extent to which this should be done will depend on national law. Moreover, also in a more shareholder-oriented company law model the board of directors of large companies will have to take the interest of stakeholders and sustainability matters into account when setting the corporate strategy due to the recently adopted CSRD as explained in the previous subsection.

3.3 *The Fear for Directors' Liability*

An often-heard argument against changes in the role of the board and adding hard law sustainability requirements for companies and directors is the fear that this will increase the risk of directors' liability. Especially in a world where companies are increasingly sued by stakeholders and Non-governmental organisations such as for example the successful case of Milieudefensie against Shell[58] in the Netherlands, there is an increased fear of court cases and directors' liability.[59] Even though the fear for personal liability of directors is understandable, it should be kept in mind that a duty of care for a board of directors does not in itself lead to directors' liability. There are still several steps to take for a claim against a director for breaching a duty of care to be successful. National law provides for rules such as the business judgement rule and/or other safeguards such as high thresholds for liability guaranteeing a limited judicial review of directors' decisions.[60] Not everything can be prevented and if a company's activities, against all reasonable steps taken to avoid negative externalities still lead to damage to for example the environment, this should not directly lead to liability of directors. The relevant question will be whether the decisions were taken with enough care and diligence. The risk for directors' liability by introducing a director's duty to include sustainability in its decision-making should therefore not be overstated.[61] Article 25 does not contain a rule of directors' liability.[62] In this respect the proposed CSDDD does not follow the path proposed by the EY study to strengthen the enforcement of directors' duties. It merely states that Member States have to ensure that their laws, regulations and administrative provisions providing for a breach of directors' duties also apply to the directors' duty of care, therefore, leaving the enforcement mechanisms entirely up to national law.[63] Whether or not the implementation of the proposed duty of care will indeed lead to an increase in directors' liability, will again depend on national law. If further reaching harmonisation is deemed desirable, it should rather focus on the procedural issues, such as whether the decision was indeed taken with enough diligence and care, rather than prescribing ex ante what the company interest should entail.

The former however does not rule out the fact that the due diligence obligations envisaged by the CSDDD and the reporting requirements under the CSRD may lead to a liability increase.[64] However, this is not so much the result of the proposed duty of care but rather of the introduction of due diligence and reporting obligations. Article 22 of the proposed CSDDD for example provides for the liability of the company for breaching its due diligence requirements. The fact that a company may (perhaps more easily after the implementation of the proposed directive) be liable for violating its due diligence obligations, can of course have an indirect effect on the liability risks for directors. Once the company is successfully held liable, the plaintiffs may sue directors for breach of their duties. Also here liability of the company however does not directly lead to the liability of the directors. Nevertheless, it may be more difficult for directors to argue that they fulfilled their duty of care if the company has violated its due diligence obli-

57 J.E.S. Hamster, 'Het voorstel van de Europese Commissie voor een richtlijn inzake passende zorgvuldigheid op het gebied van duurzaamheid: een kritische verkenning', *MvO* 2022, nr. 5-6, p. 158; S.F. ter Brake, 'Het voorstel voor de richtlijn Corporate Sustainable Due Diligence', *TvOB* 2022-3, p. 75-85; S.B. Garcia Nelen, 'Het voorstel voor een Europese Corporate Sustainability Due Diligence-richtlijn', *Ondernemingsrecht* 2022/41; H.J. de Kluiver, 'Kroniek van het Ondernemingsrecht', *NJB* 2022/952.

58 Court of first instance (Rb. Den Haag) 26 May 2021, ECLI:NL:RBDHA:2021:5337, *JOR* 2021/208. See about the increase in procedures J.E.S. Hamster, 'De verwachte richtlijn duurzame corporate governance: verantwoord ondernemen moet hoog op de bestuursagenda', *MvO* 2021, nr. 7-8, p. 276.

59 See for example the reaction of Law and Business Professors' Submission to the EU on EY's Study on directors' duties and sustainable corporate governance, M.J. Roe a.o., 'The European Commission's Sustainable Corporate Governance Report: A Critique', *Yale Journal on Regulation Bulletin* 2021, Vol. 38:152. This fear of liability is also acknowledged by the Dutch monitoring committee, see closing document of the monitoring committee 2022, p. 5. Available at https://www.mccg.nl/publicaties/publicaties/2022/12/20/slotdocument-commissie-van-der-meer-mohr-2022. The revised Dutch corporate governance code also mentions explicitly that the increased duty for directors to take into account the interest of people and the environment is not the same as a liability for directors. J.W. Winter, 'Towards a Duty of Societal Responsibility of the Board', *ECL* 17, no. 5 (2020):198.

60 M.J. Roe a.o., 'The European Commission's Sustainable Corporate Governance Report: A Critique', *Yale Journal on Regulation Bulletin* 2021, Vol. 38:152.

61 See for an analysis leading to this opinion based on Dutch law S.J. van Calker & J.P.M. Steenkamp, 'Het Shell-vonnis en bange bestuurders', *Ondernemingsrecht* 2022/31. M. Dieperink & T. Bleeker, 'Bedrijven huilen krokodillentranen om zorgplicht', *Het Financieele Dagblad* 18 January 2023.

62 H.J. de Kluiver, 'Kroniek van het Ondernemingsrecht', *NJB* 2022/952.

63 See also in this respect F. Agostini & M. Corgatelli, 'Article 25 of the Proposal for a Directive on Corporate Sustainability Due Diligence: Enlightened Shareholder Value or Pluralist Approach?', *ECL* 19, no. 4 (2022):98.

64 L.K. van Dijk & J.B.S. Hijink, 'Finalisering van de Europese CSRD: een mijlpaal voor duurzaamheidsverslaggeving met grote impact op het ondernemingsrecht vanaf 2025', *Ondernemingsrecht* 2022/87.

gations. Article 22 furthermore states that the liability of a company for damages based on a breach of due diligence obligations should not prejudice the potential liability of its subsidiaries or of any direct and indirect business partners in the value chain.[65] It will therefore be important to see how these provisions and due diligence obligations will be implemented and what the relationship will be between the due diligence obligations resting upon the parent company and those of the subsidiary as this will also have an influence on the way in which the board at the parent as well as at subsidiary level has fulfilled its duties.

3.4 *Directors' Duties in Company Groups*

As already mentioned above, it has to be admitted that Article 25 and its incorporation in the proposed CSDDD does raise questions with regard to its application to company groups. This has to do with the connecting factor used for the application of the directive. The proposed CSDDD uses a company-by-company approach rather than an enterprise approach.[66] The directive is applicable to companies of a certain size and with a specific number of employees. In order to assess its applicability to company groups, it first has to be established which company within a group of companies qualifies as a company in the sense of the proposed directive after which it has to be established which subsidiaries fall within the scope of the due diligence obligation placed upon the 'parent' company. In short, a company falls under the scope of the directive if it either has more than 500 employees (or 250 in case it belongs to a certain specific sector defined in the proposal) and an annual net turnover of more than 150 million euros (or 40 million in specific sectors).[67] In company groups this can be the parent company but it is also possible that a company at subsidiary level qualifies as such.[68] For the purpose of Article 25, directors of each company within the group that meets the abovementioned requirements falls under the duty of care. The question is how this will work out in practice. If a parent company does not qualify as a company that falls within the scope of the directive but a subsidiary does, then this can mean that even though the parent company generally sets out the group strategy, the directors at the subsidiary level will also have to make their own assessment and make sure they take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences. If the board of the parent company to which the duty is not applicable, does not take these issues into account in setting out the group strategy, the directors at the subsidiary level will have to deviate from (parts of) that group strategy. National law will then have to allow for such freedom at the subsidiary level. Under Dutch law for example, the general rule is that even if a parent company has instruction rights, the directors at the subsidiary level will always have to assess whether the instruction given is in the interest of the company at the subsidiary level and have to disregard the instruction if it is not. Therefore, from a Dutch perspective, it is not new that the directors of each company within a company group have to take the interest of their company into account and may have some freedom not to follow the instructions of the parent company. However, this may be more problematic in countries where there is a stricter group law.

4. **Conclusion**

Taking up a duty for directors to take sustainability matters into account at the European level can serve a signalling function making clear what is expected of companies and their main decision-makers. It has to be admitted that it is difficult to assess whether this will actually lead to long-term sustainable decision-making. However, if we want to take on board corporate law as one of the potential tools for enhancing sustainability, then looking at the role of the board of directors is a logical first step.

Article 25 of the proposed CSDDD aims to build on the already existing concept in national law requiring directors to act in the interest of the company and makes explicit that in doing so they should take into account the consequences of their decisions for sustainability matters, including, human rights, climate change and environmental consequences. The adoption of this article will most likely not lead to a revolutionary change in the task of directors as based on the recently adopted CSRD the board of companies falling within the scope of that directive already has to take into account sustainability issues when deciding on the corporate strategy. The proposed article fits in with developments at national level such as for example in France, Germany and the Netherlands where directors' duties (France) or corporate governance codes (Netherlands and Germany) have recently been adjusted requiring directors to take into account certain sustainability aspects of their decisions. Article 25 leaves considerable freedom to Member States to implement the duty of care. It merely sets out the outer boundaries of the decision-making. The article does not specify what the inter-

65 Article 22(3) of the proposed CSDDD.

66 See for criticism on this the contribution of Lafarre to this special issue of Ondernemingsrecht, *Ondernemingsrecht* 2023/33.

67 Article 2(a) of the proposed directive. In the version of the European Parliament these requirements are lowered to a net turnover of 40 million and 250 employees. See draft report on the proposal for a directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 (COM(2022)0071 – C9-0050/2022 – 2022/0051(COD)) of the committee on legal affairs. In the councils compromise text it is proposed to change this approach by adding a provision on due diligence at the group level. This however will not change the level at which Article 25 is applicable as the provision only relates to the due diligence obligations at the group level. The Council nevertheless also requests the Commission to report and evaluate whether the individual approach should not be changed to a consolidated approach. Compromise text of the Council, p. 5. See about this more in detail the contribution of Lafarre to this special issue. It will depend on what comes out of this whether or not this solves the abovementioned issue of application of Article 25 in company groups.

68 K.E. Sørensen, 'Corporate sustainability due diligence in groups of companies', *Nordic & European Company Law LSN Research Paper Series*, No. 22-02.

est of the company entails nor does it prescribe how the different interests involved should be balanced. A further-reaching approach would most likely also not be feasible as directors' duties at the national level are often the result of a delicately balanced system constructed by company law provisions and case law. Unfortunately, combining the more general sustainable corporate governance-related topics with the due diligence obligations at the European level has opened the door for criticism and it can indeed lead to questions for example with regard to its application in company groups. Given the fierce opposition against the European Commission's proposal and the point of view taken by the Council, it is questionable whether Article 25 will make it to the final round and will ultimately be incorporated into the CSDDD. Nevertheless, we seem to have reached a point of no return at the EU level as boards of companies falling within the ambit of the CRSD will have to at least consider the consequences of the company's strategy for sustainability matters. Corporate governance codes in Germany and the Netherlands and legislation in France furthermore also already require boards of specific companies to include sustainability in their decision-making. Therefore, also without Article 25, boards of larger companies will have to take sustainability aspects into account when setting the corporate strategy.

Davine Roessingh, Hylke ten Bruggencate, Lisanne Baks & Sven Dumoulin[1]

Practical Implications of the CSDDD: A Threat to its Effectiveness

Ondernemingsrecht 2023/39

- **Amending the concept of "value chain" to "chain of activities" (see section 3.1);**
- **Amending the concept of "established business relationship" to "business partner" (see sections 2 and 3.1); and**
- **Amendments to the civil liability regime (see sections 2.4 and 4.2).**

The CSDDD is expected to have significant practical implications for many companies and their value chains. From field research (questionnaires and follow-up discussions held with large companies in the scope of the proposed CSDDD, both listed and non-listed and including financial institutions) we have distilled the most pertinent practical implications that companies expect. This contribution discusses these expected practical implications. Although the relevant companies applaud the general aim and purpose of what the CSDDD seeks to accomplish, they also point to a number of significant shortcomings that will hamper its application in practice. These include the uncertainty of many of the expected effects and the ambiguity of many key terms and provisions of both the Commission Proposal and the Political Compromise. This may undermine the CSDDD's goal and effectiveness and already currently causes companies to incur difficulties in achieving operational and contractual readiness.

1. Introduction

This contribution discusses the practical implications of the European Commission proposal ("Commission Proposal") for a Corporate Sustainability Due Diligence Directive ("CSDDD") and the Council's Political Compromise of 30 November 2022 ("Political Compromise").

To help us identify these practical implications, we sent questionnaires consisting of approximately thirty questions related to the Commission Proposal, to a number of large companies. These companies included listed and non-listed companies, portfolio companies and financial institutions. We reviewed and analysed the responses received and held several follow-up interviews. In addition, we had a large number of discussions over the past few months with these and other companies about the expected impact of the CSDDD on their business, focusing mostly on the practical implications for their strategy and operations.

What emerges are certain pertinent implications for undertakings which may have a significant, systemic, and lasting effect on their operations in the scope of the CSDDD. The CSDDD seeks to have a remedying effect on adverse human rights and environmental impacts in the value chain. Its goal, therefore, is to enhance prosperity. It has extraterritorial effect, in the sense that the value chains in scope extend outside the EU internal market.

We are of the view that an effective and readily implementable legal framework for corporate sustainability due diligence can indeed have such a positive effect and serve as an important instrument in confronting (sustainability) challenges to enhance prosperity. In this article we focus on the *practical* implications of the Commission Proposal (and, albeit to a lesser extent, the Political Compromise).

In this article, we first explore the reception and perception of the CSDDD, covering the overall market effects the CSDDD is expected to have (*section 2*). We next address the Commission Proposal's and Political Compromise's ambiguous provisions, including the concept of business relationship, the scope of the CSDDD as included in the Commission Proposal and the Political Compromise, and the notion of groups (*section 3*). We then cover the practical considerations regarding the operational readiness of companies (*section 4*), and conclude with specific considerations for financial institutions (*section 5*).

2. A Generally Positive Attitude towards the CSDDD but Major Concerns over its Practicability and Expected Market Effects

The first notion that emerges from our research, is a positive basic attitude regarding the general concept of what the CSDDD seeks to achieve. Generally, respondents perceive the CSDDD as an opportunity and applaud its aim to drive sustainable business. Respondents perceive the CSDDD as a positive development which could further level the playing field in the European market requiring a large number of market participants to adhere to due diligence obligations. Respondents hope the CSDDD will cre-

1 Davine Roessingh is lawyer and head of the ESG group at De Brauw Blackstone Westbroek and lecturer on International Arbitration Law at the Free University (VU) of Amsterdam, Hylke ten Bruggencate is lawyer at De Brauw Blackstone Westbroek, Lisanne Baks is Legal Adviser at De Brauw Blackstone, and Sven Dumoulin is lawyer at De Brauw Blackstone Westbroek, Professor of International Company Law at the Free University (VU) of Amsterdam and General Secretary of the VEUO. This article was finalised on 30 January 2023.

ate clear obligations in an area where many already voluntarily attempt to up the ante. Respondents also expect that the adoption of the CSDDD will further escalate care for people and the planet as a board topic.

But this may be where the optimism ends. As one respondent accurately summarises the commonly held view: "*positive on the principle, less positive on the execution*". In terms of execution, respondents almost without exception raise significant concerns about the practical outcome and effects of the Commission Proposal. These concerns relate to, among others: (i) misalignment with other due diligence instruments; (ii) fragmented enforcement throughout the EU; and (iii) flaws in the level playing field the CSDDD aims to create. There are also major concerns regarding the legal aspects of the Commission Proposal, especially the large number of open norms creating significant legal uncertainty (*discussed in section 3*).

2.1 *Misalignment with other Due Diligence Instruments*

The first concern centres on the misalignment of the Commission Proposal with other existing due diligence instruments.[2] Many respondents question whether the CSDDD intends to codify existing soft law instruments (such as the OECD Guidelines) and whether its obligations correspond with the scope of the due diligence as set out in the OECD Guidelines.[3] Most respondents indicate that they already voluntarily follow the OECD Guidelines and the UN Guiding Principles on Business and Human Rights ("UNGP").[4] Respondents also mentioned following additional frameworks, such as the Principles of the UN Global Compact,[5] the UN Sustainable Development Goals ("SDGs"),[6] and sector-specific Dutch International Responsible Business Conduct agreements.[7] In following these initiatives, companies already act on potential and actual adverse human rights and environmental impacts, including further in the value chain. In our research, the question of whether adherence to these initiatives would ensure future CSDDD compliance repeatedly surfaced.

That, however, does not seem to be the case. An academic study conducted for the European Commission in 2020 showed that voluntary due diligence is done only to a limited extent at this moment.[8] The study also showed that when conducted, due diligence did not comply with all applicable guidelines and non-binding frameworks. Consequently, even when one would conclude that the CSDDD only "formalises" already voluntarily applied processes, it seems reasonable to expect that, generally speaking, current voluntary observation of the OECD Guidelines does not equal future CSDDD compliance.

In addition, the Commission Proposal seems to go well beyond the voluntarily applied principles and guidelines mentioned above. Current voluntary application of the soft-law frameworks, even if successful, are therefore unlikely to be sufficient enough to automatically warrant future compliance with the CSDDD. Several respondents point to this misalignment, which was also raised by the Dutch Association of Banks in its feedback on the Commission Proposal of May 2022.[9]

As mentioned, respondents question whether the requirements of the Commission Proposal are aligned with the OECD Guidelines and the UNGP. In any case, to avoid global fragmentation and in recognition of the efforts already made by companies to adhere to these voluntary standards, further alignment would be needed. For example, the OECD Guidelines use a risk or materiality-based approach as a key concept. A risk-based approach means that "*the measures that a company takes to conduct due diligence should be commensurate to the severity and likelihood of the adverse impact*".[10] This fundamental concept is missing in the Commission Proposal,[11] while companies adhering to the above-mentioned guidelines and standards have structured their due diligence framework on this basic principle. The Political Compromise would allow prioritisation of identified actual and potential adverse impacts where it is not feasible to address all identified adverse impacts at the same time to the full extent.[12] This leaves room for addressing the most severe and most likely impacts first (in a reasonable time), after which the company must address less significant adverse impacts. This does remain, however, a different prioritisation than the general risk or materiality-based approach under the OECD Guidelines (*see further section 3.2 below*).

2 See also: A. Lafarre, 'Mandatory Corporate Sustainability Due Diligence in Global Value Chains: The Long-Awaited European Solution Compared to Existing International Standards', *Ondernemingsrecht* 2023/33.
3 OECD Guidelines for multinational enterprises 2011 Edition (see online at: www.oecd.org/daf/inv/mne/48004323.pdf).
4 UN Guiding Principles on Business and Human Rights implementing the United Nations "Protect, Respect and Remedy" framework (see online at: www.ohchr.org). Certain EU hard-law due diligence instruments with regard to specific issues were previously introduced, such 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* L130/1 (2017).
5 The Ten Principles of the UN Global Compact (see online at: https://www.unglobalcompact.org/what-is-gc/mission/principles).
6 UN Sustainable Development goals (see online at: www.undp.org).
7 See online at: www.imvoconvenanten.nl.
8 Study on due diligence requirements through the supply chain, 2020 (see online at: https://op.europa.eu/nl/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en/format-PDF/ source-search).
9 See online at: https://www.nvb.nl/publicaties/position-papers-statements/corporate-sustainability-due-diligence-csdd-wetgeving-feedback-nvb/.
10 OECD Due diligence guidance for responsible business conduct, p. 17.
11 See also the Dutch Fiche on the CSDDD, prepared by the Working Group on Assessment of New Commission Proposals (see online at: https://www.rijksoverheid.nl/documenten/kamerstukken/2022/04/07/kamerbrief-inzake-informatievoorziening-over-nieuwe-commissievoorstellen).
12 Article 6a Political Compromise.

At the EU level, the CSDDD and the Corporate Sustainability Reporting Directive ("CSRD") are to an extent corresponding legal instruments, the first dealing with disclosure and the second with substantive provisions in relation to, in short, people and the planet. Reporting on the "*value chain*" is one of the key elements of sustainability reporting pursuant to the current draft European Sustainability Reporting Standards issued by EFRAG that are to form the actual body of disclosure standards under the CSRD. For example, ESRS S3 (Affected communities) uses the term "*value chain*", and in that respect refers to both the OECD Guidelines as well as the UNGP and UN Global Compact. From a conceptual point of view, it would seem logical that due diligence conducted pursuant to the CSDDD would feed into this reporting, at least for upstream activities. During our research, respondents have voiced concerns over a disconnect in this respect, as, in practice, it may have significant implications for how companies are required to conduct their due diligence pursuant to the CSDDD, while at the same time having to report on (the outcome of) a different process under the CSRD.

From a Dutch perspective specifically, it is worthwhile mentioning that the recently updated Dutch Corporate Governance Code, published in December 2022, reflects a notion similar to that of the CSDDD.[13] The updated Code provides that when a listed company formulates a strategy in line with its view on sustainable long-term value creation, its management board "*takes into account the impact the actions of the company and its affiliated enterprise have on people and the environment and to that end weighs the stakeholder interests that are relevant in this context*".[14] The explanatory notes to the updated Code explicitly refer to the CSDDD.

2.2 *Fragmented Enforcement throughout the EU*

A second important concern raised by respondents is the issue of potential fragmented enforcement by regulators and courts throughout the EU.[15] With the Commission Proposal, the European Commission would require companies to perform due diligence through their "established business relationships". The Political Compromise speaks of direct and indirect "business relationships", which seems to lead to an even wider pool of parties *vis-à-vis* or through whom due diligence obligations exist. The CSDDD is expected to effectively seal off the EU internal market for products and services from these business relationships that do not meet the CSDDD requirements and that pose a risk in this respect. To the extent that this succeeds, it would ensure an intra-EU level playing field as all companies in scope would perform the same due diligence and make the same subsequent decisions about which business relations to conduct business with (and which not). Respondents, however, are concerned that the interpretation of the many open norms of the CSDDD will differ significantly among national courts and regulatory authorities throughout the EU.[16] Respondents point to the risk of different interpretations of terms such as "established business relationship", "value chain" and "appropriate measure", and how national courts throughout the EU will assess whether a measure is substantively appropriate to address any potential or actual adverse impacts.[17] A certain level of harmonisation of the sanctioning regime and public enforcement at the national level throughout the EU seems required.[18] Coordination within the EU is desired and further guidance by the European Commission would be appropriate.[19]

CSDDD implementation by the different member states must be uniform to ensure the goal of establishing a level playing.[20] The Commission Proposal, however, ensures only minimum harmonisation. Consequently, member states will have considerable discretion at the implementation level. Member states can also maintain existing legislation or adopt legislation with provisions exceeding the CSDDD requirements, all posing risks to the level playing field within the single market.

Regarding Dutch implementation, one respondent stated: "*A special point of attention are national top-ups or "gold plating", when the Dutch implementation demands more than the Directive.*" This respondent, as well as others. in this respect referred to the current initiative bill for an International Corporate Social Responsibility Act (*Wetsvoorstel verantwoord en duurzaam internationaal ondernemen*[21]). It was questioned whether this Dutch proposal, which received very significant criticism from the Dutch

13 Dutch Corporate Governance Code 2022 (see online at: https://www.mccg.nl/actueel/nieuws/2022/12/20/publicatie-van-de-geactualiseerde-code-monitoring-rapport-en-slotdocument).

14 Principle 1.1 of the Dutch Corporate Governance Code 2022.

15 This is echoed in, for instance, the Joint Business Statement on the due diligence proposal of several European trade associations dated 19 January 2023 (available online at: https://ert.eu/documents/joint-business-statement-on-the-due-diligence-proposal-cs3d/).

16 See also for example the comments on Article 15 mentioned in the Dutch Banking Association Consultation Feedback, p. 2 (available online at: https://www.nvb.nl/publicaties/position-papers-statements/corporate-sustainability-due-diligence-csdd-wetgeving-feedback-nvb/).

17 See *e.g.* also: S.F. ter Brake, 'Het voorstel voor de richtlijn Corporate Sustainability Due Diligence', *TvOB* 2022, p. 79.

18 See Erasmus University consultation feedback (available online at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/feedback_en?p_id=29288521).

19 See Explanatory Memorandum to the Commission Proposal, p. 23.

20 See also the advice of the Dutch Social and Economic Council (SER), 'Effective European due diligence legislation for sustainable supply chains', *Advisory Report* 2021, p. 11.

21 In 2021, an initiative Bill on Responsible and Sustainable Business Conduct (*initiatiefwetsvoorstel verantwoord en duurzaam internationaal ondernemen*) was submitted to Dutch Parliament that covers due diligence on the broader human rights and environmental topics. In november 2022, a new version of the initiative bill was published, after severe criticism of the Council of State on the first initiative bill, see *Kamerstukken II* 2021/22, 35761-9 bill as amended following the opinion of the Council of State. We do not believe that the strong criticism of the Council of State has been sufficiently taken into account.

Council of State, should be withdrawn as national top-ups will not serve as an advantage. The members of parliament who have introduced the bill, which substantially deviates from the Commission Proposal, however, expressly wish to proceed with the parliamentary debate in order to adopt the bill in advance of the CSDDD.[22] Whether this approach will win majority support in parliament remains to be seen.

Another example of the risk of fragmentation lies in that the Commission Proposal is aimed at only individual companies, disregarding the notion that most – if not all – large(r) companies operate within a group of companies. In a scenario where member states' implementations of the CSDDD differ, a group of companies might face up to 27 different national due diligence obligations under the CSDDD, as well as 27 different enforcement and sanctioning regimes. The Political Compromise addresses this issue with the introduction of a new Article 4a on "*due diligence at a group level*" (see section 3.3 below), but whether this can adequately address the practical risk of fragmented application throughout a group of companies remains to be seen.

2.3 *Flaws in Creating a Level Playing Field*

Continuing with the topic of the CSDDD's goal of creating a level playing field,[23] most respondents welcome the Europe-wide action to ensure such common legal framework. However, many respondents did question the Commission Proposal's effects on their global competitiveness in practice. Questions were raised as to whether global – so not only EU-wide – initiatives should not be bolstered in parallel.

First, many large companies, including in our group of respondents, operate globally and consequently also compete with market players in, for example, the Americas and Asia. These companies may well face a significant competitive disadvantage compared to their competitors based outside the EU. While the Commission Proposal includes third-country companies operating in the EU market (assessed on their turnover),[24] the turnover criteria for third-country companies are based merely on their net turnover in the EU, while the turnover of EU-based companies relevant for the application of the CSDDD is their net worldwide turnover. In practice, therefore, non-EU undertakings in scope will only be very large non-EU companies with a significant turnover in the EU as compared to the European undertakings in scope.[25] These companies will likely also compete in markets outside the EU while they do not carry the same due diligence obligations in these markets with the associated costs, efforts, risk, and risk appetite. Here, we see that the extra-territorial reach of the Commission Proposal will have significant consequences for the competitiveness of EU-based corporations.

Second, small and medium enterprises (SMEs) are excluded from the Commission Proposal (and similarly excluded under the Political Compromise). In practice, however, they will qualify as the "established business relationships" or direct or indirect "business partners" of the companies that are in scope. Nonetheless, SMEs will incur the effects of the CSDDD, for instance through the contractual assurances ('contract cascading') that companies in scope will have to conclude in their agreements with SMEs according to the Commission Proposal.[26] Although the Commission Proposal (and the Political Compromise) do consider that the actual contractual terms concluded with SMEs must be fair, reasonable and non-discriminatory,[27] these terms may vary significantly, and SMEs may have to deal with diverging obligations imposed by different companies under these agreements.[28]

In practice, and importantly, this may lead to CSDDD-caused private regulation through the certification of companies in the supply chain of EU companies subject to the CSDDD. On the one hand, this runs the risk of burdening SMEs with many of the practical requirements and implications under the CSDDD in terms of resources and costs to remain eligible for business. On the other hand, it may have significant consequences for economies outside of Europe, where smaller businesses (for example, family-owned) may not be able to meet the certification requirements or will simply be replaced by larger local companies for which CSDDD certification becomes a competitive advantage.

2.4 *Risk of Adverse Market Effects*

As a last pertinent market effect of the CSDDD, many respondents alluded to the practical effects the Commission Proposal is expected to have on the strategies and companies' businesses overall, particularly the risk appetite of boards.

First, the Commission Proposal may lead to disengagement and asset partitioning.[29] Companies in scope, includ-

22 Explanatory Memorandum (*Memorie van toelichting*), *Kamerstukken II* 2022/23, 35761, nr. 10 (MvT); and bill for an International Corporate Social Responsibility Act (*Kamerstukken II* 2022/23, 35761, nr. 9).
23 See Explanatory Memorandum to the Commission Proposal, p. 2.
24 See Article 2(2) Commission Proposal.
25 See for another example the Erasmus University Feedback Document, p. 2, which regards the difference between European and third-country companies on picking a supervisory authority.
26 See Article 7(2)(b) Commission Proposal.
27 See Article 7(4) Commission Proposal and Explanatory Memorandum to the Commission Proposal, p. 14.
28 See also European Company Law Experts Group, 'Legal certainty and the directive on Corporate Sustainability Due Diligence', ECGI Blog (https://ecgi.global/blog/legal-certainty-and-directive-corporate-sustainability-due-diligence) on the unwarranted effects on SMEs.
29 See Wetzer et al., 'Dark and Dirty Assets: Greening Climate-Driven Asset Partitioning', June 2022 (available online at: https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/06/dark-and-dirty-assets-greening-climate-driven-asset-partitioning).

ing those competing with Dutch enterprises, may elect to find other alternative suppliers without addressing any adverse effects of their existing business relationships or may decide to sell any subsidiaries for which the risks of any (potential) adverse human rights and environmental impacts are perceived to be too high. The notion of "established business relationships" compounds that issue by potentially encouraging enterprises to either limit their suppliers to a more select group, or to disperse business relationships to such an extent that they are not "established".[30] The introduction of the "business partner" concept in the Political Compromise does not remedy this, as it essentially labels any commercial business partner as being part of a company's chain of activities. As a result, companies in scope might find that any type of engagement with other companies that bear any risk may simply better be terminated. That could lead to a decline in investments from the EU in developing countries, as companies in scope may divert their upstream and downstream activities away from countries where the (perceived) risk of adverse impacts is higher. The same applies to non-certified SMEs that may face a significant decline in business as commercial contracts and investments from companies in scope will be diverted to other but certified counterparts. As a result, developing countries may face more difficulties in pursuing economic growth and improved living standards and non-certified SMEs may risk being competed out of the market on (potential) risk considerations alone. This latter effect has the additional risk of elevating barriers to entry where starting businesses without certification may not even be able to enter such markets at all.

Second, Article 25 of the Commission Proposal would introduce an increased risk of director liability. The Political Compromise deleted this provision stating: "*[d]ue to the strong concerns expressed by Member States that considered Article 25 to be an inappropriate interference with national provisions regarding directors' duty of care, and potentially undermining directors' duty to act in the best interest of the company, the provisions have been deleted from the text.*"[31] However, deleting Article 25 may not remedy this completely. After all, as long as the due diligence obligations themselves are unclear and ambiguous, directors are still at an increased risk of being personally liable for non-compliance. This concern was raised by several respondents and, incidentally, is currently also the subject of a lively debate in Dutch media in the context of the aforementioned Dutch initiative bill (*see section 2.2*).[32]

Respondents – like other commentators – questioned whether the Commission Proposal will have the effect it seeks to achieve in prodding companies to conduct sustainable business to elevate prosperity standards in the undertakings' value chains. Instead, the Commission Proposal risks that companies in scope will in practice move away from a strategy of engagement to a policy of exclusion, which in turn will not contribute to, and could even contravene, the CSDDD's and the Green Deal's overall aim of creating a more sustainable global economy.

3. Ambiguity in the Interpretation of Key Terms complicate Tangible and Predictable CSDDD Compliance

Apart from the practical effects of the Commission Proposal in the EU internal market as well as globally, respondents point to the ambiguity and the lack of clarity in the key terms and provisions included in the Commission Proposal as a major complicating factor for its application. The Commission Proposal creates hard law due diligence obligations where these obligations were previously in most EU member states only voluntary in nature through soft-law and voluntary recommendations (such as the OECD Guidelines and UNGP), which were never intended nor drafted as hard law requirements. While abstract norms are an integral part of the law (for example, a 'duty of care'), clear and predictable rules are a necessity where non-compliance may have severe legal implications, and where consistent application is intended over no less than 27 different EU Member States. Respondents expect that effective implementation of the CSDDD's obligations, and thus the directive's objects, will be severely hampered by its ambiguous language.[33]

3.1 *The Concepts "Business Relationship" and "Value Chain"*

The Commission Proposal defines an "established business relationship" as 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

30 See D.C. Roessingh & D. Horeman, 'The Proposed CSDD Won't End Our Societal Sustainability Stalemate', July 2022 (available online at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/07/proposed-csdd-wont-end-our-societal-sustainability-stalemate).

31 Political Compromise, par. 31, p. 10.

32 See for instance *Het Financieele Dagblad*, 'Boskalis-topman: 'Aanzien van Nederland op het wereldtoneel bladdert af'', 2 January 2023 and *Het Financieele Dagblad*, 'Coalitie ruziet over maatschappelijke verantwoordelijkheid van bedrijven', 13 January 2023.

33 See *e.g.* also: M.S. Richter & M.L. Passador, 'Corporate Sustainability Due Diligence: Supernatural Superserious', December 2022 (available online at https://ssrn.com/abstract=4293912), p. 9; European Company Law Experts Group 2022, (ECGI Blog); P.K. Andersen et al., 'Response to the Proposal for a Directive on Corporate Sustainability Due Diligence by Nordic and Baltic Company Law Scholars', *Nordic & European Company Law Working Paper No. 22-01*, 2022 (available online at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4139249&download=yes), par. 3.2; G. Ferrarini, 'Corporate Sustainability Due Diligence and the Shifting Balance between Soft Law and Hard Law in the EU', *ECGI blog* (https://ecgi.global/blog/corporate-sustainability-due-diligence-and-shifting-balance-between-soft-law-and-hard-law-eu); and H.J. de Kluiver, 'Kroniek van het ondernemingsrecht', *NJB* 2022/952, p. 1180. Incidentally, while the CSDDD's recitals sets out that the main obligations in the directive are to be qualified as obligations of means (recital 15), this is poorly reflected in the operating provisions which specific obligations with often fixed, to be achieved objectives.

chain".[34] The Political Compromise speaks simply of direct and indirect "business partner" whereby a direct business partner is "*a legal entity with whom the company has a commercial agreement related to the operations (…)*", linking this to the concept of "chain of activities"; see below.

"Established business relationship" is one of the key terms in the Commission Proposal that is susceptible to countless interpretations while respondents state that their current assessment of whether they are sufficiently equipped to comply with the Commission Proposal and effectively identify actual or potential adverse impacts, essentially depends on the (correct and predictable) interpretation of the term. Currently, there is material uncertainty as to what the CSDDD will require in this respect and thus whether companies will reasonably be able to comply with such an obligation. This is all the more true for the assessment of indirect business partners, that is to say companies further up or down the value chain or chain of activities of an undertaking in scope. One respondent stated that "*due to the vagueness (…) it remains difficult to say how it will impact our company*". The ambiguity of the Commission Proposal and the Political Compromise in itself, therefore, seems to impede readiness (*i.e.*, preparation) and compliance.

A closely related term is "value chain", which includes all activities related to the production of goods or the provision of services by a company, including the development and use and disposal as well as the related activities of upstream and downstream established business relationships.[35] Respondents voice concerns about the inclusion of not only upstream activities but downstream ones too. The recitals of the Commission Proposal explain that downstream established relationships should be understood broadly and includes 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*".[36] The downstream value chain is, therefore, significantly broader than the downstream supply chain (which is usually understood to refer to extraction, production and manufacturing, distribution, and related activities). Respondents, in particular those with various and varied customers, noted that they generally have significantly less visibility and control over downstream activities.[37] Indeed, whether the CSDDD should extend to downstream activities has been the subject of much broader debate, including, as is evident from the Political Compromise.[38]

In light of the divergent views of member states, the Political Compromise replaced "*value chain*" with "*chain of activities*".[39] The Political Compromise also seeks to bring the concept closer to the supply chain concept and, thus, limit downstream activities to those related to the distribution, transport, storage and disposal where the business partner carries out those activities "*for or on behalf of the company, excluding the disposal of the product by consumers (…)*".[40] While the term "*chain of activities*" still results in a broad scope of CSDDD's obligation and continues to leave room for interpretation, it appears to be a clear step in the right direction when compared to the Commission Proposal to address concerns such as those voiced by respondents.

3.2 *Scope of the Due Diligence Obligations*

Respondents also raised questions about the scope of the due diligence obligations in the Commission Proposal. To start with, respondents consider the notion of "appropriate measure" ambiguous, and the CSDDD defines this term in both a broad and a vague manner:

> “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.”[41]

The Commission Proposal preamble states that the requirements are an obligation of means. However, what is appropriate in a specific situation cannot easily be predicted – and neither can be predicted how courts will interpret this requirement in light of particular alleged adverse human rights or environmental impacts. While principles can generally describe a standard of behaviour, they may lack sufficient predictability (*i.e.*, what is required of a specific company in the specific circumstances in which it finds itself?), which is especially felt if there is a liability risk. The European Commission has announced some guidance in paragraph 15 of the preamble of the Commission Proposal, which many respondents would welcome.

34 Article 3(f) Commission Proposal.
35 Article 3(g) Commission Proposal. A tailored definition applies for regulation financial undertakings.
36 Recital 18 Commission Proposal.
37 See further *e.g.*: C.J.W. Baaij & A.G. Castermans, 'De doelmatigheid van contractuele toezeggingen in de verduurzaming van handelsketens', *NTBR* 2022/48, p. 427-428, and F. Cafaggi, ‘Regulation through contracts: Supply-chain contracting and sustainability standards’, *ERCL* 2016, p. 226.
38 Explanation to the Political Compromise, para. 18.
39 Article 3(g) Political Compromise. We assume that Article 6(1) Political Compromise erroneously refers to the "value chains of activities" instead of "chain of activities".
40 Article 3(g) Political Compromise and Explanation to the Political Compromise, para. 19.
41 Article 3(q) Commission Proposal.

The due diligence and ensuing obligations centre around actual or potential "adverse environmental impacts" and "adverse human rights impacts".[42] These are (broadly) defined terms as well and refer to the Annex to the Commission Proposal. This Annex lists no less than 21 general prohibitions and obligations set out in international human rights conventions and instruments and 12 enshrined in international environmental instruments.[43] These include bans on a wide variety of topics, such as the prohibitions on child labour, all forms of slavery, the import of certain hazardous wastes, the use of mercury and mercury compounds in manufacturing processes. Moreover, Part I of the Annex on human rights obligations contains a catch-all provision with respect to 22 international instruments. These instruments apply insofar, in short, a protected legal interest is directly impaired and the company concerned could have reasonably established the risk of such impairment and any appropriate measures to be taken.[44]

Accordingly, the scope of the due diligence duty is broad, and intentionally so.[45] According to the Commission, a broad scope is required if one intends to achieve a meaningful contribution to "the sustainability transition".[46] On the face of it, defining adverse human rights, respectively, environmental impacts, provides clarity to enterprises, which some have hailed as a clear step forward.[47] Indeed, the UNGP, for example, only defines "human rights" as "internationally recognised human rights", while referencing a non-exhaustive list of key international human rights conventions,[48] whereas the OECD Guidelines' due diligence scope includes several largely undefined general topics (*e.g.*, human rights,[49] employment and industrial relations, and environment).[50] However, one should bear in mind that the prohibitions and obligations set out in the international instruments listed in the Annex not infrequently use broad, somewhat ambiguous, wording themselves.[51] Moreover, it is often not precisely clear which prohibitions for *companies* must be distilled from these primarily state and international organisation devised international instruments. The Political Compromise provides some clarity in respect of the latter, and the amended Annex only refers to obligations that can be observed by companies (rather than only by states or international bodies).[52]

A number of respondents have indicated that the broad scope of the required due diligence, in conjunction with the absence of a risk-based approach (which allows companies to select the most salient issues associated with specific business activities), will likely require a substantial investment of resources with uncertainty about full compliance remaining nonetheless. Some respondents also express concerns about the ambiguity of certain prohibitions and obligations included in the Annex and the inherent associated unpredictability.

In the same vein, conspicuously absent from the Commission Proposal is the risk-based (or materiality-based) approach employed by leading existing soft law instruments (as briefly touched upon in paragraph 2.1). A core tenet of the OECD Guidelines, for example, is that due diligence is commensurate with risk, and that it can involve prioritisation of due diligence appropriate to a company's circumstances. Accordingly, the OECD Guidelines instruct companies to carry out "*risk-based due diligence*" and expressly note that the nature and extent of due diligence may vary depending on "*the circumstances of a particular situation*":

> “Carry out risk-based due diligence, for example by incorporating it into their enterprise risk management systems, to identify, prevent and mitigate actual and potential adverse impacts as described in [these Guidelines], and account for how these impacts are addressed. The nature and extent of due diligence depend on the circumstances of a particular situation.”[53]

And similarly on human rights due diligence:

> “Carry out human rights due diligence as appropriate to their size, the nature and context of operations and

42 *E.g.*, Article 6(1), Article 6(3), Article 7(1), Article 8(1), and Article 9 Commission Proposal.

43 Commission Proposal; Annex, Part I, section 1 with respect to 'adverse human rights impacts' and Part II with respect to 'adverse environmental impacts'.

44 Commission Proposal; Annex, Part I, section 1, para. 21 in conjunction with section 2.

45 As the CSDDD remains a somewhat contentious topic, opposing views naturally exist. See, for instance, B. Sjåfjell, 'A General Corporate Law Duty to Act Sustainably', in: H.S. Birkmose et al., *Instruments of EU Corporate Governance*, Alphen aan den Rijn: Kluwer International 2023, p. 51-54, criticizing an alleged overly limited scope.

46 Recital 25 to the Commission Proposal and Commission, Questions and Answers: Proposal for a Directive on corporate sustainability due diligence, 23 February 2022, under the header 'What will companies be required to do?'.

47 *E.g.*, J.E.S. Hamster, 'Het voorstel van de Europese Commissie voor een richtlijn inzake passende zorgvuldigheid op het gebied van duurzaamheid: een kritische verkenning', *MvO* 2022, p. 153.

48 UNGP, principle 12 and commentary.

49 The OECD Guidelines' chapter on human rights, for instance, refers to a non-exhaustive list of internationally recognised human rights expressed in certain key international human rights conventions (IV, par. 39).

50 The OECD's Due Diligence Guidance do provide some examples by topic OECD, Due Diligence Guidance For Responsible Business Conduct (2018); Annex (Questions related to the overview of due diligence for responsible business conduct), p. 37-40.

51 For example, the relevant prohibition under the 1992 Convention on Biological Diversity obliges signatory states to 'adopt measures relating to the use of biological resources to avoid or minimize adverse impacts on biological diversity' (Commission Proposal; Annex, Part II, under 1 and Article 10(b) 1992 Convention on Biological Diversity).

52 This approach resulted in a number of violations being removed from the human rights section of the Annex. The human rights catch-all provision also spells out that an obligation can only exist insofar as a human right included in the international human rights instruments can actually be abused by a company (rather than just by a State) (Article 3(c)(ii) Political Compromise). A number of additional obligations and prohibitions under international environmental instruments, however, were added.

53 OECD Guidelines; General Policies, A.10. See also, *e.g.*: the OECD's Commentary on these General Policies, paras. 15-16.

the severity of the risks of adverse human rights impacts."[54]

An existing hard law instrument such as the vigilance rules set out in France's *Code de commerce* requires companies to implement *reasonable* vigilance measures ("*mesures de vigilance raisonnable*") to identify risks and prevent *serious* ESG violations ("*atteintes graves*"), allowing companies to give at least some consideration to the specific circumstances.[55]

The Commission Proposal, however, appears to disavow a risk-based approach. While the Commission proposal requires that companies deploy *appropriate* measures, which can be tailored to various factors (*e.g.*, the severity and the likelihood of the adverse impact) and even be prioritised,[56] much of this flexibility appears to be negated by the fixed objectives that these measures must achieve.[57] After all, the Commission Proposal requires that appropriate measures must be taken in order to: identify actual and potential adverse human rights impacts and adverse environmental impacts (Article 6(1)); prevent or mitigate potential adverse human rights impacts and adverse environmental impacts (Article 7(1)); respectively, bring identified actual adverse impacts to an end (Article 8(1)).

The absence of a robust risk-based approach to due diligence and ensuing obligations is a concern almost universally shared by respondents. Those respondents with existing due diligence processes (including those with quite extensive processes) almost universally apply a risk-based (or substantially similar) approach, and deliberately do so to achieve the highest impact with their available means. Consequently, the absence of a risk-based approach in most cases will not simply entail building onto any ESG due diligence framework already in place, but would require a substantial overhaul.

This brings us to other key terms of the Commission Proposal which will lead to many questions in practice and which respondents pointed to as being overly ambiguous: the meaning of the words "potential" and "adverse" in relation to human rights impacts and environmental impacts. Respondents questioned when and how it could be determined that any adverse impacts were in fact "*potential*" and "*adverse*" in the sense of the Commission Proposal. In addition, one respondent mentioned that the requirements for the quantitative information needed to determine these potential or actual adverse impacts and the required level of granularity, are unclear.

Respondents comment that they expect that the approach adopted in the Commission Proposal will impose a very significant compliance burden on them. That the nature and extent of required diligence depends on the facts of the specific case is usually considered to be ingrained in the concept of due diligence.[58] The risk-based approach employed by the OECD Guidelines on this gives companies the flexibility to adapt their due diligence processes and measures to their own circumstances and higher-risk areas. This is a sensible approach, as it allows for an effective use of resources. Employing a risk-based approach, for instance, allows a company with a large number of suppliers to identify potential higher-risk areas and prioritise suppliers for due diligence based on their risk profile and actual performance.[59] Devoting resources to areas or suppliers reasonably identified as lower risk, may well result in allocating resources with little or even no foreseeable sustainability impact. As these resources could have been deployed in a productive or more impactful manner, a broad, non-risk-based approach, appears likely to prove counterproductive.

The Political Compromise is a step in the right direction in this respect, although it still seemingly favours a more rigid approach than, for instance, the OECD Guidelines. A

54 OECD Guidelines; Human Rights, para. 5. See also, *e.g.*: the OECD's Commentary on these General Policies, paras. 15-16 and UNGP, principle 14: "*The responsibility of business enterprises to respect human rights applies to all enterprises regardless of their size, sector, operational context, ownership and structure. Nevertheless, the scale and complexity of the means through which enterprises meet that responsibility may vary according to these factors and with the severity of the enterprise's adverse human rights impacts.*" The UNGP's Interpretive Guide notes in this respect (p. 19): "*The severity of a potential adverse human rights impact is the most important factor in determining the scale and complexity of the processes the enterprise needs to have in place in order to know and show that it is respecting human rights. The processes must therefore first and foremost be proportionate to the human rights risks of its operations.*"

55 C. com., Art. L225-102-4: "*Le plan comporte les mesures de vigilance raisonnable propres à identifier les risques et à prévenir les atteintes graves envers les droits humains et les libertés fondamentales, la santé et la sécurité des personnes ainsi que l'environnement, résultant des activités de la société et de celles des sociétés qu'elle contrôle (…) directement ou indirectement, ainsi que des activités des sous-traitants ou fournisseurs avec lesquels est entretenue une relation commerciale établie, lorsque ces activités sont rattachées à cette relation.*" Although, in practice, questions of interpretation (obviously) still remain; see E. Savourey & S. Brabant, 'The French Law on the Duty of Vigilance: Theoretical and Practical Challenges Since its Adoption', *Business and Human Rights Journal* 2021, p. 141-152. These vigilance rules were established in 2017 as a result of the Duty of Vigilance Act. The severity threshold is, however, used in Article 6(2) Commission Proposal for companies in high-impact sectors and Article 7(5)(b) and 8(6)(b) Commission Proposal (prevention and termination of adverse impacts).

56 *E.g.*, Articles 6(1), 7(1), and 8(1) Commission Proposal. 'Appropriate measures' is a term defined in Article 3(q) Commission Proposal and 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*".

57 It is unclear whether this was fully intended by the Commission; recital 29 to the Commission Proposal and the proportionality analysis set out in the accompanying Explanatory Memorandum suggest that a risk/circumstances-based approach was envisaged.

58 *E.g.*, Black's Law Dictionary, 6th ed. (St. Paul, Minnesota, West, 1990) gives the following definition of due diligence: "*Such a measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent man under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case.*"

59 OECD's Commentary on the General Policies, para. 16.

new Article 6(1)(a), for example, expressly notes that companies are generally allowed to map the areas of their own operations and those of their business partners. They can subsequently carry out an in-depth assessment of the areas where adverse impacts have been identified to be most likely present or the most significant. A new Article 6(a)(1) stipulates that companies must also prioritise adverse impacts for the purposes of the prevention and termination obligations (Articles 7 and 8), where it is not feasible to address all identified adverse impacts at the same time and to the full extent.[60] Only once a company addressed the most significant adverse impacts in a reasonable time shall it proceed with the less significant adverse impacts (Article 6(a)(2)).

3.3 *Notion of the Group*

To ensure group-wide alignment of policies and practices within a group of companies, sustainability and due diligence policies are often formulated by and at the level of the parent company.[61] The OECD Guidelines recognise the notion of the group, explicitly mentioning that: "*the Guidelines are addressed to all the entities within the multinational enterprise (parent companies and/or local entities)*".[62] The Commission Proposal, however, lacks provisions on the notion of groups,[63] imposing the obligations on each individual company that meets the CSDDD thresholds. This situation would lead to a practice in which every subsidiary within a group that falls within the scope of the CSDDD needs to develop its own due diligence policies, perform its own due diligence, and draw up its own climate plan – all of which would be highly inefficient and ineffective in practice. A situation can also occur wherein a subsidiary must include other subsidiaries in its group in its due diligence practice, resulting in multiple subsidiaries performing the same exercise. Furthermore, one respondent mentioned that without minimum standards, it would be difficult to have a group-wide due diligence standard. For example, companies may in fact have to deal with standards required by local legislation, which might differ from national legislation in countries where other group companies are based (*as mentioned in section 2.2*). This concern can be addressed if the parent company can cover the obligations of the whole group.

This fundamental issue, which does beg the question to what extent the Commission Proposal was actually thought-through, has been picked up by the Council. A new provision was introduced in the Political Compromise, allowing companies to fulfil, under certain conditions, some of the due diligence obligations at a group level.[64] One respondent mentions that it is important to keep in mind that a subsidiary could have a high degree of autonomy. In such cases, it cannot be presumed that the holding company has sufficient operational control over its subsidiaries. The same may result from applicable corporate legal regimes, granting the board(s) of a subsidiary with autonomous decision-making powers.

The use of the group-related framework in the Political Compromise addresses this, by requiring adherence to certain conditions, including that a subsidiary must: abide by the parent company's due diligence policy; integrate due diligence practices into all of its policies and risk management systems; and, where relevant, seek contractual assurances in accordance with the CSDDD. The possibility of fulfilling obligations at the group level will be limited to those parent companies and subsidiaries where both fall under the scope of the CSDDD. If only the parent company is required to perform the CSDDD obligations, it must cover the subsidiary's operations as part of its own due diligence requirements. A subsidiary can share information within the group if the parent company is not in scope. Everything is without prejudice to the civil liability of subsidiaries in accordance with Article 22.[65]

Applying the due diligence obligation to groups combined with the entity-level applications thresholds of the CSDDD also has downsides. It allows a group to be structured in such a way that certain high-risk subsidiaries will not meet the CSDDD thresholds and therefore will not be subject to the due diligence obligations. This could lead to high-risk companies not having to meet the most pertinent due diligence obligations.[66]

The CSRD and the Political Compromise are not consistent on this point. CSRD thresholds include the whole group, while in the Political Compromise, each individual company must meet the thresholds to fall within the scope of the CSDDD. This could mean that a parent company is required to report on due diligence for the whole group, but does not have to ensure due diligence by its subsidiary.[67]

4. Operational and Contractual Readiness

Turning to the readiness of companies in meeting the CSDDD's due diligence obligations, a first notion arising from our research is that the vast majority of respondents state that they currently lack both the knowledge and ex-

60 The prioritisation of adverse impacts shall be based on severity and likelihood of the adverse impact. The Political Compromise explicitly stipulates that the "*[s]everity of an adverse impact shall be assessed based on its gravity, the number of persons or the extent of the environment affected, and difficulty to restore the situation prevailing prior to the impact*".
61 See also: A. Lafarre, 'Mandatory Corporate Sustainability Due Diligence in Global Value Chains: The Long-Awaited European Solution Compared to Existing International Standards', *Ondernemingsrecht* 2023/33.
62 OECD Guidelines, p. 17.
63 See on the notion of groups and the Commission Proposal also K. Engsig Sorensen, 'Corporate Sustainability Due Diligence in Groups of Companies', *European Company Law Journal*, 19(5), 2022.
64 See Article 4a Political Compromise.
65 Article 22 Political Compromise.
66 Engsig Sorensen 2022, p. 119.
67 Engsig Sorensen 2022, p. 120.

pertise, as well as the resources and capacity, to conduct the very wide-ranging due diligence efforts they believe the Commission Proposal requires. One respondent states: "*I foresee major complications in finding the right people to do the work (…)*". This is typical of many of the responses we received on this point. In this section, we discuss two sides of this coin: operational readiness as such, and contractual readiness specifically.

4.1 *Operational Readiness*

The Commission Proposal will place many demands on the internal organisations and operations of the companies in scope. Aside from having to set up an adequate due diligence framework (which may require a significant investment), the due diligence needs to be performed continuously.

Respondents specifically mention that the implementation of an effective due diligence framework within the internal organisation of companies cannot easily be included in pre-existing processes within their companies. The respondents explain that the due diligence required cannot be run in parallel with existing processes. Respondents express their doubts about how they can efficiently collect the required information from their "value chain" or "chain of activities". Companies would have to put new systems in place to comply with, for example, the monitoring requirement and the gathering of relevant data. Only the requirement to include due diligence in policies fits well within the existing policies of the companies. All else needs to be set up, also for those companies that already perform due diligence given the wide requirements and implications of the Commission Proposal. Respondents in this context also mention that due diligence is currently not part of the decision-making process of their designated sustainability committee. This, too, will have to be implemented in a structural manner that effectively complies with the Commission Proposal.

The same difficulty also applies to the setting up of a complaints procedure and the stakeholder engagement policy required by the Commission Proposal. One respondent points to the complaints procedure specifically and states:

> "The complaints procedure foreseen in article 9 of the CSDDD proposal suggests a more focused complaints procedure, specifying that complaints can be about human rights and/or environmental impact of the companies' activities, the groups of stakeholders than can lodge complaints, feedback loops and follow-up to complaints. It remains to be assessed if the complaints procedure(s) can be embedded into existing procedures and/or at what levels in the organization such procedures should be put in place. This has to be aligned with the roles and interests of stakeholders (e.g. trade unions may have a different focus than civil society organisations)."

As much as companies lack readiness on the implementation front, they lack operational readiness to carry out the actual due diligence. Respondents point to acquiring the necessary expertise and the need of embedding due diligence actions in their processes. A difficulty, as respondents put it, is that they lack "*feeling*" for the due diligence obligations that are required of them. This is in turn attributable to the ambiguity that still surrounds several of the key terms and provisions in the Commission Proposal. Respondents wonder whether they now have to employ "*dozens of FTEs to do this*" and question "*when will it be enough?*". An oft-repeated question is whether companies can at some point start sharing information derived from their due diligence. In section 3, we discussed our expectation that a certification mechanism or industry may emerge. This could help to obtain data effectively and collectively. However, as discussed, this may be to the detriment of SMEs both in the internal market as well as globally.

In all this, it should be borne in mind that companies in scope are also likely to fall under the scope of the CSRD. These undertakings are consequently currently making arrangements to comply with the CSRD in the coming years. This alone requires significant additional resources. As discussed above, it is unclear whether the efforts put into CSRD compliance will in parallel safeguard a large degree of CSDDD compliance.

The expected costs of compliance with the CSDDD have been assessed only to a limited extent. For example, in a study for the European Commission performed in 2020, interviewees indicated that "*they would not foresee any additional costs, as they are already addressing these risks*".[68] An interviewee stated that "*[f]or us it wouldn't be an additional cost in the sense that were already doing human rights and environmental due diligence. We have a lot to gain by making sure that everyone else is also doing this.*" The report points to how not only the costs of compliance should be taken into account but also the costs "*caused to society by operations (…) which violate human rights and social rights and damage the environment*". The study further discusses that other due diligence regulation has not been in force long enough to have generated information regarding implementation costs for companies. The inception impact assessment of the European Commission, also issued in 2020, also refers to a preliminary assessment of likely economic impact.[69] It states that studies estimate that complying with new corporate and directors' duties would present one-off and ongoing costs:

68 European Commission, Directorate-General for Justice and Consumers, F. Torres-Cortés, C. Salinier & H. Deringer et al., Study on due diligence requirements through the supply chain, 2020 (available online at: https://data.europa.eu/doi/10.2838/39830), par. 5.4.5.
69 Inception impact assessment dated 30 July 2020.

> "For example, the obligation to set up due diligence procedures is estimated to be less than 0.14% of the revenues for SMEs and 0.009% for large companies. Mitigating adverse impacts and implementing sustainability targets aligned with the overall long-term carbon-neutrality objective and other environmental objectives (including biodiversity-neutrality and circular economy) would also imply further costs, which could be higher in certain sectors. In this respect, in particular the company's size will need to be taken into account when determining the retained policy option. However, these extra costs should not be attributed solely to the new corporate and director duties as they derive from the necessity to attain the high-level sustainability goals to be reached at the level of the economy."

These limited studies and the expectations voiced therein are at odds with the expectations voiced in our research. Certainly, the costs of implementation and ongoing due diligence are difficult to predict, but it seems that the Commission took the approach of interviewing those who are already voluntarily applying other soft law instruments as referenced in *section 2* above, and assumes that the due diligence obligations are straightforward and clear. The Commission moreover concludes that any costs associated with the implementation of and compliance with the CSDDD obligations are negligible in comparison to the long-term benefits of the due diligence performed and the costs associated with adverse impacts prevented by due diligence. Although that conclusion can be drawn on a societal or global level, it ignores that the costs of the due diligence are likely incurred in a different place than where the benefits of the due diligence fall. Whereas this is ultimately a political choice to make, one would expect a more granular approach in establishing compliance costs with the CSDDD, also to be able to assess the CSDDD's overall effectiveness.

Finally, the Commission appears not to have considered the costs of the "*adequate measures*" to be taken, or the costs of litigation that will inevitably increase with respect to, for example, properly carrying out due diligence obligations themselves and *vis-à-vis* business partners when it comes to enforcement of policies and/or redistribution of the due diligence costs.

4.2 *Contractual Readiness*

A second readiness component is the contractual readiness for the CSDDD.[70] Overall, respondents feel that their contractual framework is not "ready" for the CSDDD. They also have not started to structurally implement contractual provisions to this effect. Article 7(2)(b), for example, requires companies in scope to seek contractual assurances from business partners with whom they have a direct business relationship, and to seek corresponding assurances in the value chain through contractual cascading. Pursuant to Article 7(4) of the Commission Proposal, these contractual assurances must be accompanied by the appropriate measures to verify compliance. The Political Compromise does not differ in this respect, although it does state that the clarifications on the joint and several liability of a company "*allowed to delete the safeguard for companies that sought contractual assurances from their indirect business partners after a strong criticism of this provision due to its heavy reliance on contractual assurances*".[71] This, however, does not remedy that companies in scope – and those conducting business with them – will need to integrate many of the obligations into their contractual frameworks throughout the value chain or chain of activities respectively.

Companies in scope will have to negotiate with their counterparts for contractual information rights to obtain information on the "quantitative and qualitative" indicators mentioned by the Commission Proposal, allowing them access to information on potential and actual adverse human rights and environmental impacts.[72] Simply put, companies will need access to information to allow them to perform their due diligence and obtain assurances as to their counterparts' compliance. This could be a contractual right to documentary information, but also a right to access premises, sites and people. These contractual provisions should not merely be put in place in agreements with direct counterparts, but should also be bargained along the value chain. As such, any concluded contracts will have to include provisions requiring the relevant counterpart to bargain for the same with indirect parties; that is, the "contractual cascading" as envisaged by the Commission Proposal needs to be put in place.[73]

In doing so, parties will have to make arrangements on the costs associated with their due diligence efforts. After all, if a company in scope concludes an agreement requiring its counterpart to provide a significant amount of information about its operations, one of the parties will need to bear the costs of collecting, providing and storing the information. In addition, parties will want to put provisions on compliance in place with, for example, privacy and antitrust regulations in collecting, providing, storing and generally processing this information. All of this will require resources, risk division and remedies. The same applies to the consequences of the provision of incorrect information. Parties will need to agree to what extent they can rely on provided information and who bears the consequences for incorrect information or assurances. Under the Commission Proposal, there does not seem to be an

70 See with respect to certain contractual considerations also: Baaij & Castermans 2022, p. 423-435.

71 Political Compromise, par. 29.

72 See Article 6 and consideration 30 Commission Proposal, and Political Compromise consideration 29.

73 *E.g.* Article 7(2) Commission Proposal.

"escape" for the performance of inadequate due diligence due to missing or incorrect information obtained from the value chain. The Political Compromise does address this in the preamble and considers that:

> "If necessary information cannot be obtained due to factual or legal obstacles, for instance because a business partner refuses to provide information and there are no legal grounds to enforce this, such circumstances cannot be held against the company."[74]

The Political Compromise is, however, unclear about the consequence where information is not obtained for this reason, leading to due diligence not being performed and appropriate measures not being taken.

Respondents foresee many issues in getting the appropriate contractual framework in place, both with their direct counterparts and further up and down their value chain to obtain the necessary qualitative and quantitative data for their due diligence. This is especially so where the value chain or chain of activities spans several steps – as will often be the case – and where the expected risks of adverse human rights and environmental impact are only present several steps up or down the contractual ladder. Respondents further expect that it will be difficult to put effective reliance mechanisms in place and are unsure as to the consequences of not being able to do so.

This is all the more true for contracts with downstream business partners. Where upstream contractual assurances to an extent present companies in scope with the possibility to determine whether the relevant activities of the contractual counterpart or upstream value chain creates a risk of causing adverse impacts (either before concluding the contract or before off taking the respective goods or services), this is to a lesser extent true for interactions with downstream business partners. Apart from seeking upfront contractual assurances that the relevant goods or services will not be used to create potential or actual adverse human rights or environmental impacts, once goods have been sold or services have been performed, the control over further use is simply out of the relevant company's control. Respondents questioned how they can be required to exert any meaningful control over this.

Respondents also have doubts as to setting up an appropriate contractual framework on the allocation of costs for any measures taken. A company in scope may have to take costly appropriate measures to prevent, mitigate or end potential or actual adverse impacts. These in-scope companies will likely want (or, for economic reasons: simply need) to reallocate and/or distribute the costs of these measures among other parties in the value chain or chain of activities. Respondents have stated not to have put any contribution rights in place in their contracts yet and are unsure as to whether this can be achieved.

Another point of unclarity in this respect seems to be the provision on civil liability in the Commission Proposal as well as the Political Compromise. Article 22 of the Commission Proposal deals with civil liability when companies fail to comply with their due diligence obligations. It provides, among other things, that this civil liability is without prejudice to the civil liability of "*its subsidiaries or of any direct and indirect business partners in the value chain*". Respondents point to this provision and ask whether in practice this means that they can make contribution claims to their direct or indirect business partners should there be an adverse human rights or environmental impact. Article 22 of the Commission Proposal seems to introduce a stand-alone ground for vicarious liability for non-compliance with the due diligence obligations. Civil liability of an indirect business partner in the value chain will likely not be based on the same, but will rather arise directly from violation of these human or environmental rights. It is unclear whether the companies in scope would have a redress claim against an indirect business partner from the former's violation of its due diligence obligations on the basis of the latter's violation of environmental regulation. These claims will be governed by many different legal regimes applying to the contractual relationships. Companies will need to take that into account as well.

Article 22 in the Political Compromise appears to aim to address this whether it provides in section 1 that "*[a] company cannot be held liable if the damage was caused only by its business partners in its chain of activities*". Damages arising out of adverse human rights and environmental impacts (that is: a violation of regulation on the same) will often only be caused by such business partners. But this is separate from the due diligence obligations of the undertakings in scope. It is unclear whether the Political Compromise considered this as this is not addressed in the "*Main elements of the compromise*". The Council only explicated the following in paragraphs 27 and 29:

> "Article 22 has been amended significantly in order to achieve legal clarity, certainty for companies and to avoid unreasonable interference with the Member States' tort law systems."

And:

> "All of these clarifications and precisions allowed to delete the safeguard for companies that sought contractual assurances from their indirect business partners after a strong criticism of this provision due to its heavy reliance on contractual assurances."

74 Political Compromise, par. 29 on p. 33.

It is doubtful whether this legal clarity is achieved and whether Article 22 of the Political Compromise will undo the necessity of contractual assurances.

All in all, it appears from our research that respondents lack operational and contractual readiness to implement the obligations enshrined in the Commission Proposal. To bring about the necessary contractual rights to information in order to properly conduct due diligence will require a major shift in the procurement and (commercial) contracting of undertakings in scope. Whether their contractual counterparts will be willing to cooperate in this effort remains to be seen.

5. Specific Considerations on the Application of the CSDDD for Financial Institutions

In our view, one category of companies warrants a separate discussion, as the practical implications of the CSDDD are expected to be distinctly different for this group, namely financial institutions.

In general, financial institutions have already been subject to ESG legislation for a longer period of time.[75] These institutions have, for example, systems in place to monitor and perform integrity risk analyses and anti-corruption compliance programmes in which ESG topics could play a role.[76] Sustainability regulations, and specifically the CSDDD, may have an impact on financial institutions' risk management systems in place to ensure sound and controlled operations.[77] Human rights due diligence and supply chain management could be part of the risk management analyses.[78] It must be considered whether a possible impact on the risk appetite of financial institutions falls inside the mandate of the CSDDD.

Existing anti-corruption compliance programmes could potentially be used as a building block for effective human rights compliance.[79] One respondent mentions that existing processes, including customer due diligence processes, product approval processes that take into account customers' needs and preferences, as well as anti-money laundering and sanction processes, mean that financial institutions will not be entering into completely uncharted territory. Yet, respondents do observe that the Commission Proposal is out of line with existing legislation and best practices. In its feedback on the Commission Proposal, the Dutch Banking Association stressed that alignment with existing legislation, and the UNGPs and OECD Guidelines, will improve the clarity and uniformity of sustainability due diligence requirements and would correspond with the sector-specific due diligence guidance already in place and prevent an unnecessary double compliance burden.[80] The wish for a better alignment with existing instruments is a view shared by respondents.

Respondents in addition welcome the tailored requirements for the financial sector as included in the Commission Proposal. For instance, the Commission Proposal provides that if the identified (potential) negative impacts cannot be prevented or adequately mitigated, financial institutions are not required to terminate certain financial services contracts when doing so could cause significant harm to the entity to which that service is provided.[81] Even so, the requirements need further clarification and improvements to be workable in practice. One respondent mentioned, for instance, that it would be of significant help to clarify how far the influence of financial institutions is deemed to reach.

One example of ambiguity in this context lies in the scope of the identification obligation of Article 6 of the Commission Proposal. While the Commission Proposal provides that, in short, financial institutions in scope should identify adverse impacts only at the inception of the contract (Article 6(3)), the prevention and termination obligations of Articles 7 and 8 apply to financial institutions and Article 10 provides that companies must carry out periodic assessments to monitor the effectiveness of various obligations under the Commission Proposal. One respondent commented that clarity regarding the interaction of these provisions would be welcomed, a view that is more widely shared by European financial institutions.[82] The Political Compromise is an important step in the right direction in this respect, as it clearly provides that financial institutions should identify the adverse impacts only at the inception of the service and they are not required to assess the adverse impacts in a dynamic way or at regular intervals.[83] Periodic assessments are only required to monitor the effectiveness of the prevention, mitigation, bringing to an end, and minimising the extent of actual or potential adverse impacts previously identified.[84]

75 For example the the Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 201 on sustainability-related disclosures in the financial services sector) and the Taxonomy Regulation (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).
76 D.S. Schreuders, 'Mensenrechten due diligence als onderdeel van 'Social' in ESG', *FR* 2020/7, p. 51.
77 Schreuders 2020.
78 Schreuders 2020, p. 51.
79 Schreuders 2020, p. 51.
80 The Dutch Banking Association also expressed its support for such an approach; see for instance the position papers published on the association's website: https://www.nvb.nl/publicaties/position-papers-statements/corporate-sustainability-due-diligence-csdd-wetgeving-feedback-nvb/.
81 Article 7(6) Commission Proposal.
82 See *e.g.*, European Banking Federation, ***Position paper on the Corporate Sustainability Due Diligence Directive***, dated June 2022, p. 5.
83 Recital 30 Political Compromise.
84 Article 10(2) Political Compromise.

Some respondents commented that it is unclear whether the identification obligation entails that the assessment is to be made for each contract and each financial product individually or at the client level. In terms of the contractual assurances that should be accompanied by appropriate measures to verify compliance, it remains unclear what exactly is expected of financial institutions and what qualifies as "inception". For example, in the context of project financing with several milestones, both the Commission Proposal and the Political Compromise are unclear as to the concrete actions to be taken.

Lastly, financial institutions deal with a variety of activities of clients, while the Commission Proposal focuses on more overarching activities and responsibilities. The risks of adverse impacts could be higher when a bank finances a project as compared to providing general corporate loans or vice versa, depending on the contractual framework. The financial institution will need to have systems in place to deal with risk scenarios that come with the different activities, which will be difficult in practice. Tailoring the requirements to the diverse activities of financial institutions could be helpful.

6. Conclusion

What emerges from our research is that respondents applaud the general aim of the CSDDD. They see the added value of due diligence in their value chains and believe it can have a positive and lasting impact on people and the planet.

However, our research also uncovered considerable uncertainty on the part of companies in scope. With this uncertainty comes a looming possibility that the CSDDD will not be as effective as it could be. In particular, respondents appear to be looking for certainty and guidance on the key terms and provisions used and on the correct execution of the various due diligence obligations, which are all very broadly defined. The current uncertainty seems to be preventing companies from effectively achieving operational and contractual readiness as well which, in turn, may have consequences for them in the years ahead (and, ultimately, on the CSDDD's effectiveness).

The practical implications of emerging sustainability regulation like the CSDDD and the more imminent CSRD will be quite significant for the respondents. These instruments are expected to have a lasting impact on their operations (and, presumably, on their financial results). Such impacts should go hand in hand with sufficient clarity and legal certainty which, our research has shown, is currently lacking in both the Commission Proposal and the Political Compromise.

Particularly given that the objectives that the CSDDD seeks to achieve are of high importance, that the CSDDD will need to be implemented and enforced in 27 different EU Member States, that civil liability is a genuine risk, and that prioritization of efforts is only allowed to a limited extent, more clarity and guidance should be provided from the outset. It would be even better if the CSDDD would allow for prioritisation, and take into account the influence companies can expect to be exerting in the many, distinct parts of their value chains, while clearly distinguishing the upstream supply chain from the downstream travel of products and services.