Eurochambres position on the Proposal for Corporate Sustainability Due Diligence

Eurochambres reiterates that sustainability is at the heart of businesses activities and is key to ensuring long-term economic growth. European businesses are ready to commit to an even stronger responsible business conduct if EU institutions adopt a well-balanced regulatory framework on corporate due diligence.

However, Chambers consider that the Commission's proposal on Corporate Sustainability Due Diligence does not guarantee the legal certainty and harmonisation needed in terms of scope, reporting standards, liability, and enforcement modalities. The proposal also adds considerable administrative and regulatory burden, and without the proper adjustments to make it workable, may have a real social cost at a time of long-lasting disruptions, delays and protracted supply shortages affecting the Single Market.

Finally, Chambers consider that the proposal falls short to deliver the necessary level playing field in a globalised economy where less scrupulous competitors wait to take over market shares that EU businesses will be obliged to abandon once compliance with EU standards of protection has been proven unattainable. Chambers therefore urge the co-legislators to fully reconsider how such short-sightedness might in reality affect the level of protection in certain regions of the world that the proposal intended to serve and enhance.

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1. General remarks

Eurochambres considers that the proposal on Corporate Sustainability Due Diligence (thereafter the "Proposal" or the "Directive") critically impacts companies' operations and respective supply chains. The most important goals of the proposal should be to **guarantee harmonisation, level playing field, effectiveness, and legal certainty across Member States**. It is important as well as to abide by **the Think Small First principle**, with full consideration of SMEs needs, and to avoid undue administrative burden. Despite the high level of expectations and a series of legal mishaps leading up to its adoption, Chambers consider that **the Proposal falls short on its promises and does not contribute to these goals**.

Complex legal concepts and vaguely defined key terms create legal uncertainty for businesses, as noted by the Regulatory Scrutiny Board, and will result in difficulties when transposing and implementing the Directive across the EU. The Proposal continues to conflate two parallel concepts - due diligence and sustainable corporate governance – and presents a bias against **European companies due to unattainable obligations that go far beyond** (or even contradict, in certain cases) **existing legislation** at the national level. The nature of the due diligence obligations under the Directive as obligations of means does not really alleviate the compliance costs. The wide discretion given to Member States e.g., when it comes to administrative sanctions will also contribute to more fragmentation in the Single Market.

In order to maximise coherence between the Proposal's strategic objectives and its intended outcomes, it is necessary to create an informed and positive attitude among businesses toward due diligence. Internationally established guidelines clarify that businesses have an independent responsibility to respect environmental and human rights, but this does not mean that they should be made responsible for factors over which they have no control. Accordingly, States have a crucial role and responsibility in this discussion following the fundamental principle of the rule of law.

Entrepreneurs need a stable legal environment, a conditio sine qua non for responsible trading. This can only be achieved by **making the corporate due diligence process as streamlined and clear as possible**.

2. Key points

- **Proportionality**

In the last decades, European companies have made substantial efforts to increase their responsibility and sustainable impact in global chains and, in many cases, contributed to enhance environmental and labour standards in less diligent jurisdictions.

However, **businesses have varying degrees of influence along their supply chain** and cannot accept the imposition of legal obligations over an extremely broad coverage of operations which, as a rule, they are unable to comply with or thoroughly verify. Adopting the concept of "established business relationship" beyond tier 1 companies is problematic because tier 2-n business partners are often unknown and contractually sensitive information should not be disclosed.

The focus should instead be on process requirements, based on the values and principles of international guidelines on due diligence, that support businesses' continuous performance improvement and avoid unnecessary costs linked to monitoring obligations for each supplier. **The Proposal needs to be more practice-oriented than theorical in scope, in order to have more chances to attain its objectives.**

The Proposal also indicates that if companies are unable to mitigate or stop severe human rights and environmental impacts they must suspend or terminate the business relationship. This is seemingly incompatible with international covenants on economic development as well as Article 16 of the Charter of Fundamental Rights of the EU on the freedom to conduct a business. In addition, considering that in certain cases, these markets will most certainly be overtaken by third-country competitors, which are not always subject to the same standards of protection, the above solution seems to contradict the objectives of the Proposal.

Eurochambres believes that due diligence should be **proportionate, risk-based, and sector-specific**. The **Proposal should thus only have practical implications for large companies' own operations and up to their respective tier 1 suppliers**.

- **Articulation with existing guidelines, rules and initiatives**

Any **deviation from the UNGPs and the OECD guidance** aimed at introducing additional requirements and checks upon businesses **will have detrimental effects** on the companies' speed of adaptation to the due diligence procedures and will result in an increase of the reporting costs.

Mandatory due diligence requirements must be aligned with international frameworks – OECD Guidelines on Responsible Business Conduct and UNGPs on Business and Human Rights – and should avoid legal pitfalls with existing legislation in the same policy area e.g., Shareholder Rights Directive and the future Corporate Sustainability Reporting Directive, in addition to a wide variety of existing sectoral legislation that regulates business relations. **It is essential to preserve the alignment with international standards** to guarantee a reasonable corporate responsibility within global supply chains.

Existing **industry standards** developed by market participants are essential and can help raise the bar across the Single Market. Companies must be able to rely on the legal sufficiency of compliance of these instruments with the assistance of the Commission and Member States in order to mitigate compliance costs. Since these initiatives also help to establish risk management and other preparatory activities, they should not only be used for contractual assurances, but also to fulfill due diligence obligations. Information platforms and digital solutions for due diligence are crucial for companies and must therefore be made available before the Directive enters into force.

The Commission and the European External Action Service should also play a more prominent role in inspiring third countries towards responsibly identifying, preventing and mitigating risks in their economies with the support of grassroots support organisations.

- **Impact on SMEs**

Despite being excluded from the scope of the proposal, **SMEs will be indirectly impacted**.

A misleading and ill-informed image focusing only on the exclusion of SMEs from the direct personal scope of the Directive, only shows the lack of understanding of how the Directive has been designed to work and how business relations function in practice. SMEs are part of global value chains of in-scope entities and will be thereby required to prove compliance with those entities' obligations under the Directive. In addition, SMEs face difficulties in conducting due diligence because their traceability and compliance costs need to be covered based on a lower turnover. More efforts should be made by Member States to help SMEs in accommodating the changes brought by the Proposal and reaping the benefits of the Single Market.

Lawmakers must guarantee that SMEs remain out of the scope of the Proposal, **address the contractual cascading** and **focus on targeted support measures** e.g.:

- carefully examined model contractual clauses that balance responsibilities across the supply chain and limit the constraints that may fall on smaller suppliers;
- easily accessible information portals, hotlines, good practices databases, and free capacity-building sessions for SME owners and entrepreneurs;
- adoption of SME-specific chapters in existing industry schemes and companies'

procurement charters;
- collaborative actions between the EU and third countries to create more responsible supply chains at the global level.

To limit the costs linked to the considerable additional bureaucratic burden, and in accordance with the “one in, one out” principle, Member States must also be obliged to financially compensate SMEs for their efforts to pursue legal compliance.

- **Directors’ duties**

A large number of EU companies integrate ESG considerations in their business strategy and include sustainability when assessing their financial performance. Modifying the notion of directors’ duties through imprecise considerations risks creating legal loopholes and the notion that due diligence oversight could be achieved through modifications to company law is baseless and could result in frivolous actions against the interest of companies, deflecting attention away from the real culpable.

It is important to recognise that directors may become risk averse if the liability risk faced by them is too high, thus forgoing investment opportunities in favor of less attractive alternatives. Any hard law intervention in corporate governance will contribute to jeopardise director liability in accordance with an unknown number of externalities on which the management has no control, and result in breaching their duty of care vis-à-vis the companies’ and the shareholders’ interests.

Board members should be allowed to define who the relevant stakeholders are, disclose on the chosen engagement methodology and report on how they integrated their interests during their decision-making.

At the same time, EU lawmakers need to carefully consider the corporate governance ecosystems that exist in each Member State, which already provide sufficient incentives for directors to apply a duty of care, and guaranteeing that Boards of Directors, shareholders and investors focus on ensuring that companies create economic and sustainable growth. Shareholders nowadays warrant effective control due to their right to vote on the remuneration of the Board, whose performance should be assessed using both financial and non-financial performance criteria including ESG factors where appropriate.

The Proposal’s provisions on directors’ duties risk disrupting effective legal systems implemented in Member States and the careful balance achieved through national company law, corporate governance codes and well-established business practices. They show that the Commission has unfortunately based its choices on erroneous and biased presumptions towards directors, which will only increase insurance costs and create a risk aversion environment where qualified personnel shall no longer accept mandates. In addition, **there is no need for this matter to be further regulated at EU level**.

- Boards must retain the ability to adapt their corporate strategies to the particular needs, considering pre-established liability safeguards and their fiduciary duties. Over time, this will allow the development of sustainability expertise instead of going through redundant tick-the-box exercises. Flexibility in the decision-making process of the management body is more appropriate in light of the externalities that management has no control of and the necessity to avoid decisional deadlocks.
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- The need for the company to adopt a plan compatible to limiting global warming to 1.5 °C, in line with the Paris Agreement on climate change, and variable remuneration linked to it is overly ambitious and represents a competitive disadvantage vis-à-vis third country companies not subject to a similar duty.
  - Even though the adoption of such a plan is not part of the due diligence obligations and directors' liability does not seem to extend to it, it remains unclear how companies could ensure that the business model and strategy are compatible with the limiting of global warming.
  - As regards variable remuneration, it is also unclear how the authorities in charge of enforcing the Directive's provisions following its transposition into national law, can have access to the various components of such individual remuneration which in principle are not made public.
- Lawmakers should not question the legitimacy of directors in addressing stakeholders' input in a flexible manner.

Chambers believe that the Commission should explore the opportunity of creating an **Expert Group specifically dedicated to sustainable corporate governance** to identify best practices on stakeholder engagement with the support of business representatives and maximise sustainable value creation based on existing corporate governance models and the valuable work developed by the members of the European Corporate Governance Codes Network (ECGCN).

The Commission should also take a more **flexible approach and adopt a Recommendation for Member States centered around alternative forms of companies aimed at purposes beyond the sharing of profit** based on existing national initiatives e.g., "benefit companies" in Italy.

Chambers call for a revised balanced approach as regards directors' duties, taking into consideration both the intrinsic difficulty of balancing divergent interests of multiple stakeholders for directors and the real objective of actively promoting sustainable management, and advocate for an educational approach, practical support and conclusive examples of good practices are necessary to this effect for persons acting as directors.

- **Civil liability**

Chambers believe that the proposal introduces overly complex and inadequate liability clauses. Companies may be held liable for harms committed at home or abroad by their subsidiaries, contractors and suppliers, and potential third country victims will have the opportunity to file lawsuits before EU courts. This will result in a bigger burden for companies with fewer resources and a higher risk for damages that are beyond their control.

The inclusion of such clauses is unsuitable because companies cannot be charged for potential damages in their (as it now stands) entire value chain if they did not cause these damages, could not reasonably know about them, or if they took the appropriate measures to prevent and remediate them.

Chambers believe that, instead of targeting businesses with the possibility of an additional regime of civil liability, regulatory incentives should be considered as more effective tools.

Due diligence obligations on direct and indirect business partners should be preferably discussed independently of damages.

- **Inclusion of the financial sector**

The Proposal is largely tailored to challenges of primary sectors, which makes it difficult to apply it to the financial sector where detailed sectoral regimes already apply. Regulated financial undertakings are subject to various regulations on sustainability-related matters and ESG factors are already captured by provisions relating to due diligence and stewardship both on asset managers and product levels and related publications[1] so it is redundant to capture once again the same actors in the scope of the proposal.

Due diligence on the entire investor chain could be challenging (or even unfeasible) to implement for funds with a high number of investors and/or large international investor chains. Effective due diligence is feasible only in the context of the financial services company and the natural/legal person receiving the service. Finally, investment funds should not be assimilated to corporates and a clear exemption regarding investment funds should be considered. Clarifications are also needed on the inclusion of venture capital SPVs and (re)insurance holding companies in the scope of the proposal.

The chamber network encourages the Commission to reconsider the inclusion of the financial sector in the Proposal taking into account the existing robust financial regulatory framework.

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[1] AIFMD and UCITS delegated acts regarding sustainability risks and factors, SFRD, SRD II, OECD key considerations for responsible business conduct for institutional investors. The stewardship role of asset managers is already prominent and extends even to the objectives of the Paris Agreement, long-term sustainable creation, etc.