The draft EU Corporate Sustainability Due Diligence Directive: what legal consequences on companies and board members?

A joint ecoDa / Crowell & Moring Webinar

As the long-awaited European Commission proposal on Corporate Sustainability Due Diligence (CSDD) was released on 23 February 2022, ecoDa and Crowell & Moring organized a webinar to discuss the likely consequences of this extensive draft EU legal instrument in terms of companies' and directors' liability.

If international organizations such as the OECD and the United Nations provided guidance on due diligence as soon as in the 1970s, the Rana Plaza accident in 2013 was a watershed moment from which national governments decided to legislate to avoid such terrible events in the future (France in 2017, Germany in 2021...). As a result of both the willingness to avoid fragmentation in the European internal market and the pressure of the European Parliament (which adopted in 2021 a resolution with recommendations on corporate due diligence and corporate accountability), the European Commission proposed the CSDD.

What is the draft directive about?

The aim of the CSDD is to tackle human rights and environmental impacts across global value chains. New corporate due diligence duties will therefore be imposed on large EU and third-country companies as well as on smaller ones operating in high-risk sectors. Companies falling in the scope will have to:

- Integrate human rights and environmental due diligence in their corporate policies - this obligation going further for large companies that will even have to align their business model with the Paris Agreement;
- Identify, prevent, mitigate and bring to an end potential adverse impact to human rights and the environment;
- Establish a complaints procedure for affected or potentially affected persons and organizations;
- Monitor the effectiveness of their due diligence policies and update them on an annual basis;
- Publicly report and communicate on the ESG-compliance.

With these broad obligations come along increased (litigation) risks and sanctions. Any individual or legal entity will be able to raise substantial concerns to the relevant supervisory authority when they believe that a company is failing to comply with the CSDD. The national supervisory authorities will be granted extensive powers to initiate investigations and to take remedial actions (pecuniary sanctions...).

What shortcomings should the European Institutions address?

As the CSDD will now be discussed at the European Parliament and Council levels, our panel made some recommendations to make it more realistic, clear and viable for European companies without undermining its intended goals.

It has been recalled that despite the negative opinion that seems to have been conveyed by the proposal about European companies and their alleged immobilism, sustainability is a core strategic issue for many companies. Integrating ESG considerations into decisions (including in remuneration schemes) is no longer a choice if companies want to attract talent, thrive and survive in the long term. To successfully embrace this new reality, the CSDD should be less about complaints and sanctions, possibly leading to excessive legal disputes, but more about accompanying measures (through exchange of best practices, board education programs...).

The rather punitive approach taken by the European Commission risks being counterproductive. Large companies might transfer certain requirements on smaller suppliers who do not necessarily have the resources to cope with them. Companies might also abandon some countries to avoid potential risks, as they cannot oversee their entire value chain across the world, including their indirect business relationships.

Thereupon, the German example is much more realistic, limiting the due diligence rules to direct suppliers along the supply chain (and not the value chain). Aligning with these safeguards will provide European companies more clarity and legal certainty, two crucial elements if Europe wants to attract enough investments to lead the sustainability transition.

One article perceived as particularly dangerous is article 25 of the draft CSDD, dealing with directors' duties. The provisions of this article, which is drafted in a rather confusing and unclear way, seem to breach the subsidiarity principle by introducing a duty of care concept in national company law.

Finally, the speakers recalled that sustainability is everyone's responsibility. Regulators cannot make the transition solely dependent on good business conduct. For this reason, the article on public tenders should be reintroduced in the proposal.

A comparison with the US environment

Whereas US companies experience the same strong investors' pressure to adopt sustainable behavior, the two continents have taken a different approach to ESG due diligence. The United States are following a more laissez-faire kind of approach with sustainability reporting frameworks developed voluntarily by the private sector. This trend is largely driven by peer pressure and a desire to differentiate. However, as these reporting frameworks offer conflicting appraisals of companies, it has resulted in more important accusations of greenwashing. US companies are therefore asking for more clarity on ESG reporting (more than 75% of the answers to the U.S Securities and Exchange Commission consultation on climate disclosures in March 2021 were in favor of increased or mandatory ESG disclosures).

If the SEC has proposed a new environmental disclosure set of rules[1], this move is not without political ramifications. Republican members of the US Congress have indicated that the SEC has overstepped its authority. As a consequence, it is very likely that the proposed rules will be challenged by US Courts, making their effective implementation uncertain.

Except the initiatives taken on the 'E', the SEC declined to pursue guidance more broadly related to the S and G components. As a result, US companies face an unprecedented wave of shareholder resolutions focused on ESG in 2022 (a 22% increase since last year while there was actually a record of 300% increase in ESG related investment suits in 2021).

To conclude, if we should expect legislative divergence in the coming years on S and G standards across the Atlantic, investors are unlikely to lessen the pressure on corporate boards pushing US multinationals to voluntarily comply with EU or other ESG disclosure standards exceeding US requirements.

1: These proposed rules would require registrants to report on several things: company's climate related risks and actual or likely material impacts on business, the firm's governance of climate related risks and relevant risk management processes, the business greenhouse gas emissions...

Speakers: Anselme Mialon *(Deputy Head of the Sustainable Finance, Corporate Law, Accounting and Corporate Governance Unit, French Treasury)*, Andrew Blasi *(Director, Crowell & Moring International)*, Leena Linnainmaa *(Chair, ecoDa)*, Daniela Mattheus *(Board Member, Commerzbank AG and Chair of of the Financial Expert Association)*, Alessandra Stabilini *(Vice President, Nedcommunity),* Frederik van Remoortel *(Partner, Crowell & Moring Brussels),* Sakine Yilmaz *(Associate, Crowell & Moring Brussels).*

The recording of this webinar is available here.

Contact

ecoDa

Béatrice Richez-Baum, Director General:
contact@ecoda.org , Tel: 003222315811

Manon Roehrig, Policy Adviser
policy@ecoda.eu, Tel: 00439933970

www.ecoda.eu

Crowell & Moring

Andrew Blasi, Director, Crowell & Moring International Washington, DC:
ABlasi@crowell.com

Frederik van Remoortel, Partner, Crowell & Moring Brussels:
FVanRemoortel@crowell.com

Sakine Yilmaz, Associate, Crowell & Moring Brussels:
Yilmaz@crowell.com

https://www.crowell.com