# The proposed EU Corporate Sustainability Due Diligence Directive: more clarity needed to avoid excessive legal disputes

ecoDa - Position Paper

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ecoDa

The European Voice of Directors

# Introductory remarks

ecoDa welcomes the European leadership in promoting sustainable supply chains in Europe and beyond. Breaching human rights and overlooking the environment can no longer be acceptable business conducts.

However, the long-awaited proposal on sustainable corporate due diligence falls short in delivering realistic, clear and viable rules for companies. Furthermore, ecoDa would like to recall that all corporate governance related initiatives (from CSRD to Taxonomy) should not overlap and should take account of the reality and needs of European companies to succeed in their sustainability journey while preserving their competitiveness. Double efforts should not be imposed on European companies because of overlaps of legislations. This risk of overlaps also exists regarding the creation of additional national authorities to supervise the implementation while some authorities have already full competence at least in the financial sector.

## A possible confusion between supply chain and value chain

While global value chains refer to a form of organization of production and international division of labor between different countries/regions, the notion of supply chains is restricted to the import of products. By referring to value chains, the European Commission makes it possible to integrate subsidiaries, subcontracting and other sourcing, cross-border cooperation and not just imports. It also makes it possible to deal with diligence when it comes to R&D, logistics, transport, customer service (call centers for example). But as the text does not use these terms, a reference to supply chains should have been sufficient. Keeping the terminology of value chains would create confusion regarding the scope of responsibility encountered by the companies concerned furthermore that most international texts to which the draft directive refers in its annex concern supply chains.

## An artificial connection between due diligence and corporate governance

Generally, the proposal deals with a company law matter, which is a matter for national legislation, and the connection with corporate governance is too artificial and does not make real sense. The text only insufficiently integrates the operational departments of a company (purchasing department, communication department, international department, etc.). In addition, the implementation of article 25 would go through an arsenal of soft law and processes at the companies' level: drafting of rules, training of employees, organization of control, internal audits, investigations by external third parties, improvements, even sanctions by severing contractual relations.

## An insufficient and confusing clarification on directors' duties

The proposal does not provide useful clarifications on the notion of directors' duty of care. On the contrary, the artificial imbrication of due diligence and directors' duties results in confused articles (25 and 26). It is unclear if these latter relate only to due diligence. Board members do not need more legislation but more examples of good practices and consistent environmental and social standards. ecoDa is also pleading for finding the best way for directors to consider the relevant stakeholders' views (which might differ according to sectors, geography, size...). However, the articles do not provide any clarity on how directors should incorporate conflicting interests of stakeholders and sustainability aspects. In addition, existing company law rules at EU level already provide sufficient incentives for directors to apply a duty of care. Recent case laws have shown that the national legislations are clear enough to engage the company or directors' responsibility (Shell case, for instance).

In addition, if the concept of "duty of care" may be familiar in common law, it remains unknown by most continent civil laws. For instance, the key concept for directors' civil liability in French case law is the "faute de gestion", while the term used in the French version of the proposal is "devoir de sollicitude" - a term that is unknown in French law. ecoDa wonders how will the concept of duty of care be introduced in the legal systems which do not know it?

For the above mentioned reasons, ecoDa would encourage the institutions to clarify article 25 and make it coherent with national legislations. If this is not achievable, ecoDa would therefore recommend the deletion of this article to avoid unnecessary confusion.

## An exacerbated risk of litigation for companies

As a general matter, liability provisions have to be drafted carefully. The broader power given to every stakeholder to challenge the decisions taken by the board will result in numerous and paralyzing legal disputes for the company. The fact that all natural and legal persons are entitled to submit concerns when they think that a company is failing to comply with the Directive will lead to time-consuming and endless justifications from the company and possibly even to US-style litigation. Efforts will therefore be redirected to communication rather than on the strategic intended goal of the Directive. Only stakeholders directly affected should be able to bring a complaint.

The text is far too unclear on which type of liability could be engaged (vicarious liability, direct liability, etc.). The French example demonstrated that a clarification was necessary and was provided by the constitutional council. A company should be able to avoid legal liability by showing that it has undertaken the due diligence required in the circumstances.

This also raises the question of how litigation will be covered by D&O insurance.

These uncertainties and the limitless extension of liability will turn European companies into risk adverse entities whose competitiveness will ultimately decline over time. The risk is also that companies will tend to select the most risk adverse directors which would be detrimental for European competitiveness.

Overall, ecoDa would like to insist on the need to mitigate article 25 and to further clarify the liability regime as described in the draft directive to make it more realistic and to diminish the risk of gold-plating by some Member States. A too ambiguous scheme would result in the absence of liability which would be contrary to the European Commission’s primary objective. It is all the more crucial to get a more conceivable regime that Member States will otherwise apply it differently, breaching the level playing field.

## A very limited balance between European and non-European companies

ecoDa supports the European Commission proportionate approach to include third country companies while excluding SMEs from the direct scope of the proposed Directive. This will limit the risk of unfair competition with global competitors who do not have to comply with similar rules in their home country. However, ecoDa would encourage the enlargement of the scope as the Directive currently includes too few third-country companies. The criteria applicable to EU companies and non-EU companies are not balanced. The net turnover of EUR 150 million is taken worldwide for EU companies, while for non-EU companies the same amount of net turnover accounts for the part earned in the EU only. The non-EU companies will therefore easily compete on the EU market without respecting the terms of the proposal.

In addition, ecoDa welcomes the European Commission's intention to develop accompanying measures to support companies, suppliers and SMEs affected as part of supply chains. However, these contemplated measures are unclear (the proposal refers to financial support but how would that work, under what conditions?).

The European Commission should both further limit the potential burden and cascading requirements and expectations on SMEs (to what extent a parent company can pass on its responsibility to its suppliers?) and further specify how parent companies can support SMEs that will be indirectly affected by the Directive.

## Due diligence should be considered at group level

The due diligence requirements should apply at the group level and not at the corporate level which would result in costly processes with each subsidiary being subjected to a specific review by local authority.

## The business sector alone cannot lead the sustainability transition

ecoDa regrets the absence of a clause on public procurement. The business sector alone cannot lead the sustainability transition. Furthermore, the European Commission should refrain from imposing that business models and strategies are compatible with the limiting of global warming to 1.5°C, in line with the Paris Agreement, as Member States themselves are unable to comply with this objective. Companies should be given the flexibility to disclose their own targets based on their sectors, activities and location. Moreover, whether the actions taken to meet these objectives are adequate will inevitably be subject to diverging opinions by outsiders and raise controversies between experts.

## Due diligence rules that might have counterproductive effects

ecoDa is afraid that the proposed due diligence obligations that will weigh on companies are not realistic. Indeed, European companies cannot control and oversee their entire value chains across the world, including their indirect business relationships. The risk is to simply force companies to disengage from some markets and terminate business relationships. Disengagement in some countries might have real impacts on the socio-economic model of the country concerned and the quality of life of its inhabitants. There is a significant risk of leaving market shares open to non-European competing companies. Moreover, the significant dependence of Europe, particularly in the energy sector, raises questions about the feasibility of a sudden disengagement of its companies in certain countries.

Furthermore, the potential disengagement of European companies from some countries will inevitably undermine their competitiveness and therefore, their attractiveness from an investor standpoint. Such a scenario would have detrimental consequences for European companies at a time where capital flows and investments are crucial to pursue the sustainable transition.

## Remuneration: a useful incentive if correctly applied

ecoDa invites the European Commission to further clarify the notion of remuneration as used in the proposal (article 15). Indeed, the Commission tends to not distinguish executive and non-executive remunerations schemes as well as short-term and long-term incentive plans. In addition, ecoDa pleads for the deletion of article 15 paragraph 3 which does not target listed companies and also goes far beyond the Shareholder Rights Directive's scope.

## Clarification required on the notion of directors

The concept of directors as it is in the text is imprecise, especially in article 26 where the Commission tends to confuse the management and the board. Also, such confusion may arise in how management could be interpreted by one-tier and two-tier boards. In addition to this clarification, ecoDa would like to recall that it is not the role of the board to put in place the due diligence actions, as mentioned in the draft directive, but that of the management.

## Clarification required on the notion of established business relationships

Clarification on the notion of established business relationships as expressed in recital 20 is required in the body of the text. Responsibilities should vary depending on the direct or indirect nature of the business relationships as it is the case under the recent German Due Diligence law.

## Education: a neglected game changer

At ecoDa, we strongly believe that a change in mindset on ESG matters will happen through education of board members. It is preferable to rely on the training of directors to embrace sustainability issues. This approach would prevent creating loopholes in terms of all aspects that would not be specified in a legislation. The EC should therefore make a clear reference to the importance of certification and in the interest of the internal market to arrive at some common criteria in terms of ESG education for board members. ecoDa invites the European Commission to release a budget line for the training of directors on ESG matters as it was done, some time ago, for the training / mentoring of women directors.

## A non-existent client integration

The draft directive does not include the client, who is a major player at the end of the chain in these due diligence dynamics. The draft proposal should be accompanied by an accounting approach that would integrate the indirect costs of distant value chains or implications of countries with little regard for human rights or environmental damages.

## A high risk of legislative fatigue

The European Commission is increasingly using delegated acts. This approach does not follow the usual legislative and democratic process and should be used on an exceptional basis.

## Trust in the business world to develop soft law is necessary

The European Commission is taking more and more the role of business organizations by developing guidance. In addition, we are witnessing an increasingly marked administration of business with a role increasingly devolved to national authorities to monitor companies without them having a comprehensive understanding of the business world.

## About ecoDa

About the European Confederation of Directors Associations The European Confederation of Directors Associations (ecoDa) is a not-for- profit association founded in December 2004 under the laws of Belgium. Through its 22 national institutes of directors (the main national institutes existing in Europe), ecoDa represents approximately 55,000 board directors from across the EU. ecoDa's member organizations represent board directors from the largest public companies to the smallest private fi rms, both listed and unlisted

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