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COMMENTARY ON THE PROPOSAL FOR A DIRECTIVE ON CORPORATE SUSTAINABILITY DUE DILIGENCE

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1

INTRODUCTION

1. INTRODUCTION

Since the start of the 21st century, the EU has adopted various initiatives offering different approaches and different scopes that all promote responsible corporate conduct. The European Parliament has made statements and resolutions on this topic on several occasions. Nevertheless, the European Commission's Renewed EU Strategy 2011-2014 for Corporate Social Responsibility includes the EU's undertaking to promote the United Nations Guiding Principles on Business and Human Rights (hereinafter, the UNGPs) and to implement them by means of a smart mix of voluntary and mandatory measures to achieve responsible corporate conduct, both within and outside the EU, and to ensure that companies are accountable for their social and environmental impacts.

The European Green Deal proposes reforms to reinforce the framework for corporate governance. The proposal for the Directive on corporate sustainability due diligence is set within the context of both the EU's undertaking to implement the UNGPs and the reforms of the corporate governance framework. This policy paper examines the European Commission's proposal from the perspective of a critical analysis of its provisions, with the aim of reflecting on its potential for the identification, prevention, mitigation of, and accountability for, the negative impacts of businesses on human rights and the environment.

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BACKGROUND

2. BACKGROUND

On 29 May 2018, the European Parliament requested from the Commission in its Resolution on sustainable finance (2018/2007(INI)) the introduction of a proportionate mandatory due diligence framework, based on the 2017 OECD Guidelines for Responsible Business Conduct for Institutional Investors. The Parliament proposed that this pan-European framework should be based on the French Law on the duty of vigilance of parent and sub-contracting companies.

On 8 March 2018, the Commission published a communication entitled Action Plan: Financing Sustainable Growth, in which Action 10 states: Fostering sustainable corporate governance and attenuating short-termism in capital markets envisages that the Commission will carry out analytical and consultative work with relevant stakeholders to assess, among other issues, the possible need to require corporate boards to develop and disclose a sustainability strategy, including appropriate due diligence throughout the supply chain, and measurable sustainability targets.

In February of 2020, the European Commission published a Study on due diligence requirements through the supply chain. The study focussed on market practices, regulatory frameworks and options for regulating due diligence in business operations and in their supply chains.

On 29 April 2020, the European Commissioner for Justice, Didier Reynders, announced, during an online event organised by the European Parliament Working Group on Responsible Business Conduct, the Commission's undertaking to introduce due diligence obligations in the area of human rights and the environment, as part of the Sustainable Corporate Governance initiative.

In December of 2020, the German presidency of the European Council requested from the European Commission a proposed EU legal framework on sustainable corporate governance that would include cross-sector due diligence throughout the global supply chains so that companies could identify, prevent, mitigate and become accountable for their adverse impacts on human rights, employment rights and the environment.

On 27 January 2021, the European Parliament Committee on Legal Affairs (JURI) adopted a European Parliament Resolution with recommendations for the Commission on corporate due diligence and corporate accountability (2020/2129(INL)).

On 23 February 2022, the European Commission published the proposed directive on corporate sustainability due diligence and amending Directive (EU) 2019/1937, with the aim of guaranteeing that companies that operate in the EU market contribute to sustainable development and to the transition towards sustainable economies and societies by identifying, preventing, mitigating and minimising the potential or actual adverse human rights and environmental impacts connected with businesses' own operations, subsidiaries and value chains.

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ANALYSIS

3. ANALYSIS

The UNGPs constitute a milestone in the debate that has been taking place since the 1970s on the negative effects that business activities in all sectors have on people and the environment. One of the main advances of the UNGPs is that they make clear that businesses, regardless of their size, sector, operational context, ownership and structure, have a responsibility to respect human rights. This is realised through the exercise of human rights due diligence, which constitutes the cornerstone of the UNGPs' Pillar II.

According to the UNGPs, due diligence is a risk-management process that all businesses should incorporate for the purpose of identifying, preventing, mitigating and accounting for how to remedy the potential and actual negative human rights impacts caused, wholly or in part, by their activities, or that are directly linked with their operations, their products or services provided by their business relationships.[1] This process consists in a set of interrelated processes, which must include four basic elements:

- Identifying and assessing the potential or actual adverse human rights impacts that the company may cause or contribute to through its activities, or with which it has a direct relation through its operations, products or services provided by its business relationships;
- Integrating findings from impact assessments across relevant functions and company processes and taking appropriate action according to its involvement in the impact;
- Monitoring the efficacy of the measures and processes adopted to counteract the adverse human rights impacts for the purpose of knowing if these are producing results;
- Communicating on how impacts are being addressed and showing stakeholders that there are adequate policies and processes in place to implement respect for human rights in practice.

The widespread institutional acceptance of UNGPs has generated the social expectation that businesses will put into practice processes of due diligence as part of their corporate responsibility to respect human rights. For this reason, human rights due diligence has been integrated into the main instruments that promote responsible corporate conduct,

1. See RUGGIE, John Gerard y SHERMAN, John F, "The Concept of 'Due Diligence' in the UN Guiding Principles on Business and Human Rights: A Reply to Jonathan Bonnitcha and Robert McCorquodale", *European Journal of International Law*, vol. 28, núm. 3, 2017, pp. 921-928.

such as the 2011 OECD Guidelines for Multinational Enterprises, the ILO's 2017 Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy and the ISO's 26000 guidance on Social Responsibility. In this respect, it is worth highlighting the OECD's work, since not only has it developed a cross-sector guide on due diligence, but it has also developed a series of guidelines to help businesses carry out due diligence processes that enable them to achieve responsible corporate conduct in specific sectors and supply chains: minerals, agriculture, textiles and footwear, extractive industries and finance. These *soft law* tools contribute to producing better understanding and common methodologies so that businesses can consolidate habitual practices for identifying, preventing, mitigating and giving account for the potential or actual adverse effects on human rights.

Throughout the UNGPs' first decade, the practice among businesses of implementing processes of due diligence has been limited because of the lack of coherence or adequate comprehension of what was actually involved in the process.[2] Hence, empirical studies show that the majority of businesses continue unaware, without the capacity to apply human rights due diligence, or without showing any intention of doing so.

In the face of businesses' limited voluntary implementation of human rights due diligence, there have emerged, or are in the process of being developed, legal frameworks of mandatory due diligence that impose legal requirements on certain enterprises, based on the UNGPs' Pillar II, that range from the disclosure of non-financial information to the development of monitoring plans, so that they may address in a proactive way their adverse human rights and environmental impacts.[3] These normative developments have occurred mainly in Europe. Since the Law on the duty of vigilance of parent and sub-contracting companies, approved in France in 2017, the first national measure that legislated for corporate human rights due diligence in all sectors, several European jurisdictions, such as Germany, Netherlands and Norway have pushed for similar legislative initiatives. Other States, such as Spain or Switzerland, are discussing similar instruments at the behest of civil society or are in the course of preparing them in national Parliaments.

2. See, CONSEJO DE DERECHOS HUMANOS, "Décimo aniversario de los Principios Rectores sobre las Empresas y los Derechos Humanos: balance del primer decenio. Informe del Grupo de Trabajo sobre la cuestión de los derechos humanos y las empresas transnacionales y otras empresas", 22 April 2021, A/HRC/47/39; CONSEJO DE DERECHOS HUMANOS, "Informe del Grupo de Trabajo sobre la cuestión de los derechos humanos y las empresas", 16 July 2018, A/73/163.

3. IGLESIAS MÁRQUEZ, Daniel, "La debida diligencia en materia de derechos humanos: Estado de la cuestión y perspectivas", *Tomo XVI. Derechos humanos y Empresas de la Colección de Estudios en Derechos Humanos,* Comisión Estatal de Derechos Humanos Jalisco, Instituto de Derechos Humanos Francisco Tenamaxtli, 2022, pp. 32-65.

At the regional level, the EU has adopted sectorial instruments with provisions relating to the exercise of human rights due diligence, such as the Non-Financial Reporting Directive, that demands that companies covered by the regulation publicly disclose their policies, their processes of due diligence, the main risks and management of those risks, in particular the risk to human rights. Another such norm is the Conflict Minerals Regulation, which demands that importers of minerals and metals into the EU carry out processes of human rights due diligence in line with the OECD's Guide on due diligence for responsible supply chains in areas of conflict or high risk. Also noteworthy is the proposal for the Regulation on deforestation-free supply chains, that prohibits introducing into the market certain raw materials and their derived products if compliance with the requirement that such material be "legal" and "deforestation free" cannot be established by due diligence.

The normative developments in mandatory due diligence form part of the "smart mix" of voluntary and binding measures that States must adopt to promote respect for human rights among businesses. These laws not only represent a "hardening" of the *soft law* standards relating to responsible corporate conduct, but they also have the potential to incentivise and encourage human rights due diligence as part of ordinary business practices, since they can provide greater legal certainty for businesses, while at the same time contributing to creating a greater understanding and uniformity of the requirements that must be complied with in order to fulfil their responsibility to respect human rights.[4]

Nevertheless, without independent monitoring and supervision mechanisms, the practice of companies in exercising due diligence can become a box-ticking exercise. In addition, without complementary provisions on liability if prevention fails, there is a risk of leaving affected parties without an effective remedy for damage and loss inflicted by business activities.

Such laws can give clarity to companies as regards the human rights due diligence that they must carry out. This could help to create fair conditions for businesses, by giving legal force to human rights due diligence, educating stakeholders and the general public on the business' activities and, ultimately, reducing the risks of adverse human rights impacts..

4. CONSEJO DE DERECHOS HUMANOS, "Improving accountability and access to remedy for victims of business-related human rights abuse: The relevance of human rights due diligence to determinations of corporate liability Report of the United Nations High Commissioner for Human Rights", 1 June 2018, A/HRC/38/20/Add.2.

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THE EUROPEAN COMMISSION'S PROPOSAL FOR A DIRECTIVE ON CORPORATE SUSTAINABILITY DUE DILIGENCE

4. THE EUROPEAN COMMISSION'S PROPOSAL FOR A DIRECTIVE ON CORPORATE SUSTAINABILITY DUE DILIGENCE

Despite the considerable delay, the proposal of a Directive on corporate sustainability due diligence constitutes an advance in the EU's efforts to regulate business's human rights and environmental impacts. The proposal is modelled on the existing international *soft law* standards, such as the UNGPs and the OECD guidelines, as well as the laws on due diligence that have been adopted in France, Germany and Norway. These norms are intended to achieve the following goals:

- Improving the practices of corporate governance.
- Avoiding the fragmentation of due diligence requirements in the single market and creating legal certainty for businesses.
- Improving corporate accountability for the adverse impacts and ensuring adherence for companies in respect of these obligations.
- Improving access to remedies for those affected by the adverse impacts of corporate behaviour on human rights and the environment.
- Complementing other current measures or proposals that directly address some specific sustainability challenge or that apply in specific sectors, mainly within the Union.

The proposal for a Directive brings together several elements and provisions that have the potential to promote respect for human rights and the environment, and that contribute to transforming the European business model, empowering the victims of corporate abuse and even helping the EU to attain a leadership position in respect of mandatory due diligence measures. Nevertheless, for that purpose it is important to attend to the limitations and gaps that the proposals presents, for example, in respect of the scope of material and personal application of the supervision mechanisms and the accountability regimes.

MATERIAL SCOPE

The proposed Directive covers the potential and actual adverse human rights adverse impacts and environmental adverse impacts of businesses' own practices, those of their subsidiaries and the activities along the value chain as regards the entities with which the businesses maintain an established business relationship. Article 3.c defines "adverse human rights impact" as an adverse impact on protected persons resulting from a violation of any of the rights or prohibitions of the international agreements that appear in the list appended to the Directive Proposal's Annex. According to Article 3.b, "adverse environmental impact" is understood to be an adverse impact on the environment resulting from the violation of any of the prohibitions and obligations established by the international environmental conventions that are listed in part II of the proposed Directive's Annex.

The Annex to the Proposal of the Directive lists a series of specific rights (the right of people to dispose of land's natural resources, the right to life and security, the right to liberty and security, the right to enjoy just and favourable conditions of work, among others) from international human rights instruments (the Universal Declaration of Human Rights, the International Agreement on Civil and Political Rights, the International Covenant on Economic, Social and Cultural Rights, the Convention for the Prevention and Punishment of the Crime of Genocide, the Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment, among others) and international environmental conventions (the Convention on Biological Diversity, the Convention on the International Trade in Endangered Species of Wild Fauna and Flora, the Minimata Convention on Mercury, the Vienna Convention for the Protection of the Ozone Layer and its Montreal protocol relating to substances that exhaust the ozone layer, among others) that businesses must respect by complying with the due diligence obligations.

On a positive aspect as regards the UNGPs, the Directive Proposal expressly widens the spectrum of rights that businesses must respect. In addition, the Directive Proposal covers international environmental conventions, since theses do not appear in the UNGPs' list of instruments that identify the rights that businesses must, as a minimum respect in their activities. In fact, references in the UNGPs to the environment are quite limited[5] in comparison with the Directive Proposal.

5. PIGRAU SOLÉ; Antoni; JARIA I MANZANO, Jordi; "La aplicación de los Principios Rectores sobre Empresas y Derechos Humanos en el caso de los daños al medio ambiente causados por empresas españolas en terceros países", en Carmen Márquez Carrasco (Ed.), *España y la implementación de los principios rectores de las Naciones Unidas sobre empresas y derechos humanos: oportunidades y desafíos*, Huygens, Barcelona, 2014, pp. 301-332.

Nevertheless, despite the proposal's annex containing a wide range of rights and international instruments that businesses must respect in their operations, it is a selective list that does not guarantee an exhaustive cover for human rights nor for the negative impacts on the environment. Moreover, there is no coherent explanation in the Directive Proposal on the development and selection of the rights and instruments that are included in the annex. This selection, on the one hand, risks promoting a selective application of human rights and environmental norms and, on the other hand, it omits a significant number of rights and international instruments that may be violated by a business' activities. For instance, the annex makes no reference to European human-rights instruments, such as the European Convention on Human Rights or the Geneva Convention of 1949 on international humanitarian law. As regards the environment, it does not consider the 2015 Paris Agreement or the Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters (the Aarhus Convention) of 1998.

Therefore, by limiting the material scope of the Directive Proposal to certain rights or instruments, it overlooks the fact that businesses can have an impact on practically the whole spectrum of internationally recognised human rights and can affect the environment in different ways, so that their responsibility applies to all recognised rights and implies the duty to prevent any environmental damage.

PERSONAL SCOPE

The personal scope of the Directive Proposal presents a mixture of light and shade. Article 2 establishes the following criteria that should identify the businesses that will be subject to the due diligence obligations:

- Companies formed according to the laws of one of the Member States, with an average of more than 500 employees and a net worldwide turnover of more than 150 million Euros in the last financial year.
- Companies formed according to the laws of one of the Member States, with an average of more than 250 employees and a net worldwide net turnover of more than 40 million Euros in the last financial year, provided that they operate in sectors that have a high impact.
- Companies formed according to the laws of a third State, that have generated a net turnover of more than 150 million Euros in the EU during the last financial year.

- Companies formed according to the laws of a third State, that have generated a net turnover equal to or less than 150 million Euros in the EU during the last financial year, provided that they operate in sectors that have a high impact.

The companies falling within these categories must comply with the due diligence obligations in relation to the potential and actual adverse human rights and environmental impacts of their own practices, those of their subsidiaries and the activities along their value chain as regards the entities with which the businesses maintain an established business relationship.

Perhaps the main virtue of the personal scope under the Directive Proposal is that it covers businesses in third States, acknowledging that the volume of trade creates territorial links between businesses in third States and the EU, since the activities of those businesses can have effects in the internal market, which is enough to entail that the laws of the EU should apply to such businesses. As such, the personal scope under the Directive Proposal is wider than its counterparts in domestic jurisdictions, which only apply to businesses that are registered or that have a branch in the State concerned. Nevertheless, it is estimated that it would cover only 4,000 businesses outside the EU, and the monitoring mechanism for compliance with the due diligence obligations for these businesses is not made clear.

Generally, it is expected that the application of the future Directive will cover only 1% of the EU's businesses, some 13,000 companies, since it excludes from the due diligence obligations small and medium enterprises (SMEs), that, as indicated in the explanatory memorandum of the Directive Proposal, represent around 99% of all businesses in the EU. It is considered that for this category of business, the financial and managerial burden of establishing and applying a process of due diligence would be relatively heavy, and so the Directive Proposal contemplates, positively but in a limited way, financial aid for SMEs that might be exposed to burdens arising from their business relations with businesses included in the scope of personal application. Thus, in France, the Duty of Vigilance Law has affected 80% of the French SMEs that are not directly subject to that law but that must implement some measure of due diligence since they supply larger businesses that are covered by the law.[6]

6. BRABANT, Stephane; BRIGHT, Claire; NEITZEL, Noah; SCHÖNFELDER, Daniel, "Due Diligence around the World: The Draft Directive on Corporate Sustainability Due Diligence (Part 1)", *VerfBlog*, 2022/3/15.

The Directive Proposal's scope of application focuses mainly on *very large* businesses, which, according to the explanatory memorandum, already have processes of due diligence in place. This puts in doubt the effectiveness of the instrument's scope, since it is not directly furthering nor expanding this mechanism among businesses that still do not implement, have knowledge of, or the capacity for, processes of due diligence.

The Directive Proposal also covers businesses that operate in sectors of high impact:

- The manufacturing of textiles, leather and related products (including footwear) and the wholesale trade of textile, clothing and footwear, agriculture, forestry, fishing (including aquaculture).
- The manufacture of foodstuffs and the wholesale trade of agricultural raw material, live animals, wood, food and beverages; mineral resource extraction, regardless of place of extraction (including crude oil, natural gas, anthracite and coal, lignite, metals and metal ores, as well as all other non-metallic minerals and quarry products).
- The manufacture of basic metal products, other non-metallic mineral products and processed metallic products (except for machinery and equipment), and the wholesale trade of mineral resources, basic and intermediate mineral products (including metals and metal ores, construction materials, fuels, chemical products and other intermediate products).

The selection of these high-impact sectors is based on the OECD's existing sector guidelines on due diligence. But the selection excludes, among other issues, the finance sector, despite its inclusion in the OECD's sector guidelines, since it is considered that owing to its specificities it should not be included among the high-impact sectors contemplated by the Directive. Nevertheless, the *very large* companies in the finance sector are in fact covered within the Directive Proposal's scope of personal application. But the text of the proposal contemplates several exceptions: for example, regulated financial businesses that offer loans, credit of other financial services must only identify adverse effects at the start of the contract. In addition, their due diligence obligations only relate to their large corporate clients and other businesses in their corporate group.

In this light, the Directive Proposal, as with the majority of normative developments in this area, departs from the UNGPs, which indicate that all businesses, regardless of their size, sector, operational context, ownership or structure, have a responsibility to respect human rights. At the same time, the UNGPs recognise the proportionality of this responsibility when they point out that the magnitude and complexity of the measures available for businesses to

assume this responsibility may vary according to these factors and according to the severity of the negative consequences of the businesses' activities on human rights. Nevertheless, these limitations may be overcome by means of the review clause provided in Article 29 of the Directive Proposal, which allows for the possibility of reducing the thresholds relating to the number of employees and the volume of turnover where it is necessary to meet the objectives of the European instrument.

DUE DILIGENCE OBLIGATIONS

The personal application imposes on Member States the duty of ensuring that the companies falling within the scope of personal application conduct human rights and environmental due diligence. These processes should comprise the following elements:

- Integration of due diligence into their policies (Article 5).
- Identification of actual and potential adverse impacts (Article 6).
- Prevention and mitigation of potential adverse impacts, ending actual adverse impacts and minimisation of the scope of the impact (Articles 7 and 8).
- Establishment and maintenance of a complaints procedure (Article 9).
- Monitoring the effectiveness of their due diligence policies and measures (Article 10).
- Public communication on the processes of due diligence (Article 11).

The due diligence expounded in the Directive Proposal aligns to a great extent with that of the UNGPs and the OECD guidelines. However, it also presents some innovations and some shortcomings. For example, with regard to the undertaking of businesses to integrate due diligence into its policies, the Directive Proposal indicates that they must establish a due diligence policy that features a description of the focus applied by the business to its due diligence, a code of conduct describing the norms and principles to which the businesses' employees and subsidiaries must adhere and a description of the processes established for applying due diligence. It differs from the UNGPs and from the OECD guidelines in that it does not contemplate that this policy could be adopted at the business' highest level or that it should be made public and that it applies internally and externally to all staff, partners and other stakeholders, which reduces the transparency of adopted policy. On a positive note, and in line with the OECD's recommendations, Member States must ensure that businesses annually update their due diligence policies.[7]

7. Updating the business' policies as and when risks in its activities, supply chain and other business relations arise and develop. See, OCDE, *Guía de la OCDE de Debida Diligencia para una Conducta Empresarial Responsable*, París, OCDE, 2018.

As regards the identification of the actual and potential adverse human rights and environmental impacts, companies must adopt the *appropriate measures* to identify the actual and potential adverse impacts on human rights and the environment that ensue from their own activities or from those of their subsidiaries and businesses with which they have business relationships established along their value chains. The term *appropriate measures* is understood as 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.

In line with the UNGPs, the Directive Proposal empowers businesses to use independent studies in order to identify adverse impacts. However, it departs from the UNGPs in its provision that establishes that, *where appropriate*, businesses will consult with potentially affected groups, such as workers and other stakeholders, for the purpose of gathering information on the potential or actual adverse impacts. This provision grants some discretion to businesses in carrying out such consultations. In the UNGPs, substantive consultations with potentially affected groups and other stakeholders play a key role in the identification and assessment of the actual or potential negative consequences on human rights and UNGPs, in order to evaluate the impact of their activities on human rights, businesses should try to understand the concerns of stakeholders who might be affected, consulting with them directly and bearing in mind questions of language and other factors that might impair effective communication. In fact, the UNGPs indicate that it is not possible to hold such consultations, businesses must consider reasonable alternatives, such as consulting sound and independent experts, including defenders of human rights and other actors in civil society.

Once the adverse impacts have been identified, the Directive Proposal contemplates a different approach depending on whether the business has detected *potential adverse impacts* or *actual adverse impacts.* However, in either case, Member States should demand that businesses adopt, *where applicable*, the appropriate measures to prevent *potential* adverse impacts or to bring to an end *actual* ones and, if the actual ones cannot be brought to an end, Member States shall ensure that the scope of those adverse impacts is minimised. The measures that companies must adopt in approaching a potential or actual adverse impact are very similar, with some additional requirements in the case of actual impacts such as the payment of indemnity for damage and loss to affected persons and financial

compensation to the affected communities. Some of the measures provided by the Directive Proposal against adverse impacts are:

- Developing and implementing a prevention or corrective action plan, with reasonable and clearly defined timelines and qualitative and quantitative indicators by which to measure improvements (Articles 7(2)(a) and 8(3)(b)).
- Seeking contractual assurances in their direct business relationships that endorse the company's code of conduct. They must also establish the same contractual assurances with partners that form part of the company's value chain (contractual cascading) (Articles 7(2)(b) and 8(3)(c)). These assurances should be accompanied by appropriate measures for identifying their compliance (third-party verification or industry initiatives) (Articles 7(4) and 8(5)).
- Making necessary investments, such as in management or production processes and infrastructures (Articles7(2)(c) and 8(3)(d)).
- Providing targeted and proportionate support for an SME with which the company has an established business relationship (Articles 7(2)(d) and 8(3)(e)).
- Collaborating with other entities, for the purpose of increasing the company's ability to bring adverse impacts to an end, in particular where no other action is suitable or effective (Articles 7(2)(e) and 8(3)(f)).
- Refraining from entering into new relations, or extending existing ones, with the partner in connection with, or in the value chain in which, the impact has arisen, and, where the law governing their relations so entitles them to, businesses should temporarily suspend or terminate such business relations with respect to the activities concerned if the potential adverse impact is severe (Articles 7(5) and 8(6).

In comparison with other national instruments on mandatory due diligence, the Directive Proposal establishes with greater clarity a list of measures that businesses must adopt and implement, where applicable, in order to deal with the impacts of their activities and established business relationships. However, several of them have a potential limitation in modifying business practices that have an impact on human rights and the environment, as they do not encourage leading businesses to exercise their influence to prevent or eliminate those adverse impacts, according to the UNGPs.[8] For example, in the case of contractual assurances and the verification mechanisms, these have been shown to have limited effectiveness in the management of the impacts of business activities since, on occasion,

8. See, commentary on the Guiding Principle 19.

they are reduced to box-ticking exercises.[9] This kind of measure even implies a transfer of responsibility from the leading company to its commercial partners without considering the role that the latter play in the creation and prevention of the adverse impacts.

In a similar way, the measure of terminating the business relationship with regard to the activities when the adverse impact is considered severe does not take into consideration nor does it make reference to the fact that, in principle, the leading business should exercise its influence or increase it in order to prevent or eliminate those adverse impacts, whether by developing its capacity or other incentives or by collaborating with other actors. In this respect, it does not envisage, as the UNGPs do, that leading businesses need to consider the negative consequences that the decision to end the business relationship might have for the human rights situation. There is even a risk that the measure could lead to the irresponsible termination of business relationships, which could bring with it the loss of livelihoods and cause other damage to rights-holders. Finally, as regards the measures proposed in the Directive, it is worth noting that they do not require businesses to ensure the prevention or elimination of adverse impacts, since the due diligence contemplated in the Directive Proposal is an obligation of conduct.

As far as the complaints mechanisms that businesses must implement are concerned, the active standing to submit complaints to these mechanisms is limited to affected persons or those with substantiated reasons to believe that they may be affected by the potential or actual adverse impacts, and to unions and other workers' representatives, as well as to civil society organisations, but only those active in those areas related with the affected value chain. In addition, the mechanisms provided under the Directive Proposal depart form the complaints mechanisms at the operational level contemplated in Principles 38-31 of the UNGPs. As such, the Directive Proposal's complaints mechanism does not fulfil the expectations of the UNGPs, as there is no requirement that such mechanisms be legitimate, accessible, predictable, safe, equitable, transparent, rights-compatible and a source of continuous learning, according to the effectiveness criteria under Principle 31. Additionally, it is worth noting that the Directive Proposal does not mention that these mechanisms empower the company to address any detected damage and to redress the negative consequences early on and directly.

9. See, *Beyond social auditing. Key Considerations for Mandating Effective Due Diligence*.

Finally, another aspect subject to improvements in relation to the requirements of due diligence that businesses must fulfil are the obligations of communication. In this regard, the Directive Proposal does not create new obligations to disclose information on businesses' due diligence processes; rather, it tries to complement the existing regime by indicating that Member States should ensure that businesses not bound by the requirement to disclose non-financial information under Directive 2013/34 EU report on those aspects regulated by the Directive Proposal and publish an annual declaration on their webpage. For a greater disclosure of information on the due diligence processes that companies implement, such disclosure should be collected on a centralised European platform, supervised by the competent national authorities and offering to stakeholders fluid access to information on companies in relation to the proposed Directive.

THE SCOPE OF THE DUE DILIGENCE OBLIGATIONS IN THE VALUE CHAIN

Article 1 of the Directive Proposal indicates that the due diligence obligations of businesses in relation to actual and potential adverse human rights and environmental impacts cover businesses' own operations, those of their subsidiaries and along the value chain by means of their established business relationships in a similar way to France's Duty of Vigilance Law. In this respect, in accordance with the Directive Proposal, *business relationship* is understood to mean 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. One question that arises over this definition is that the Directive Proposal does not specify how long-term this relationship should be. Nevertheless, it does indicate that, if a direct business relationship is established, the indirect relationships linked with it should also be considered in relation to the business in question.

It is a positive aspect of the due diligence obligations contained in the Directive Proposal that they include the value chain. However, the fact that it includes only established business relationships limits the scope of the obligations. This brings the risk that businesses will only detect and address adverse impacts at the first level along the value chain and not on those levels where the more severe and urgent adverse impacts occur and which should be addressed as a matter of priority. It is for this reason that the UNGPs do not limit the process of due diligence to a particular type of business relationship since in that case corporate responsibility to respect human rights would be limited to preventing the impacts of strategic and closely connected suppliers, ignoring those that produce in the more remote parts of the value chain.

Elsewhere, the fact that the due diligence obligations are limited to established business relationships creates a perverse incentive for businesses, since they will seek to avoid these kinds of lasting relationships that fall within the scope of European legislation on these issues. In this way, businesses might be tempted to choose short-term relationships that do not fall within the proposed Directive for the purpose of avoiding the due diligence obligations and the associated responsibility.

SUPERVISORY AND COMPLIANCE MECHANISMS

As regards application, one of the innovations and advances, which the Directive Proposal takes from the German Supply Chain Due Diligence Act is the requirement that Member States must endow one or more national public authorities with supervisory and executive authority to ensure that businesses comply with their due diligence obligations. These supervisory authorities should form part of a European Network of Supervisory Authorities composed of representatives, with the aim of facilitating and ensuring the coordination and harmonisation of regulatory practices and practices relating to research, sanctions and control, as well as the exchange of information between such supervisory authorities.

The supervisory authorities should not only have adequate finance, but they should also be independent. Moreover, Member States must also ensure that the authority staff, as well as the auditors and experts who act on its behalf, exercise their powers impartially, transparently and with due respect for the duties of professional secrecy. They should also ensure that they are free from any conflicts of interest, that they are subject to the requirements of confidentiality and that they abstain from any action that may be incompatible with their functions.

Among the main powers of the national supervisory authorities, the following are proposed:

- Requesting information and carrying out investigations (on its own motion or when they have received communication of some substantiated concerns) relating to compliance with the obligations established under the Directive Proposal (Article 18(1) and (2): a positive aspect to note about this provision is the right of every legal person and entity to present their substantiated concerns to any supervisory authority when they have good grounds for believing that, objectively, a company is in breach of its due diligence obligations. In the Directive Proposal, the standing required to present concerns is much wider than that under the German legislation, which provides only for affected parties to have recourse to the supervisory authority for reporting failure to comply with due diligence.

- Carrying out inspections after having given prior warning, except where such prior notification would hinder the effectiveness of the inspection (Article 18(3)): the prior notice should be the exception and not the rule, since companies could conceal signs of actual or potential adverse impacts.
- Requesting that companies take remedial action, if such measures are possible (Article 18(4): the adoption of remedial action does not exclude the imposition of administrative sanctions, nor does it exclude the possibility of civil liability in the event of damage and loss.
- Ordering the cessation of infringements, imposing pecuniary sanctions and adopting interim measures to avoid the risk of serious and irreparable damage (Article 18(5): Member States should establish a regime of effective, proportionate and deterrent sanctions to be applied in the event of a breach of the due diligence obligations. The Directive Proposal indicates that the imposition of sanctions is a discretionary power of the national supervisory authorities which, when imposing such sanctions, must consider the company's efforts in applying the corrective measures as well as its cooperation with other entities in addressing the adverse impacts in its value chain. Financial sanctions would be based on the company's turnover.

CIVIL LIABILITY

Another noteworthy aspect of the Directive Proposal, although it is subject to amendment, is the provisions of Article 22 on civil liability. This provision, similar to what one might find in the French Duty of Vigilance Law, is not only the key to compliance with the due diligence obligations, but also to ensuring access to effective reparation for persons affected by the adverse impacts that should be identified, prevented and eliminated from business activities.

Article 22 requires that Member States regulate the civil liability of businesses when a failure to comply with the due diligence obligations produces an adverse impact that causes damage and loss. That is, according to the Directive Proposal, the civil liability of businesses arises from the adverse impacts on the environment and on people who suffer damage and loss, who could claim indemnity. In fact, this regime of civil liability is reinforced by the Directive Proposal itself, as it indicates that the national law that transposes Article 22 should be mandatory and overriding in those cases in which the law applicable to claims to that effect is not the law of a Member State.

Despite the positive aspects indicated above, it is worth noting some areas for improvement. The Directive Proposal provides a defence mechanism that allows businesses to avoid liability for damage caused along the value chain. It establishes that businesses shall not be liable for damage caused by an adverse impact resulting from the activities of an indirect partner with which the business has an established business relationship, provided that they have established contractual assurances and verification measures. This liability exemption shall not apply if it was not reasonable to expect that the measures taken were adequate to prevent, mitigate, eliminate or minimise the adverse impacts. According to the explanatory memorandum that accompanies the Directive Proposal, this approach limits the risk of excessive litigation. Nevertheless, it anticipates the liability of businesses that have insufficient contractual assurances, or which are a mere formality.

Finally, it is worth noting that the Directive Proposal establishes a regime of subjective civil liability (negligence), under which the burden of proof falls on the claimants. This is one of the main obstacles facing affected people in bringing actions against businesses and it is exacerbated by the lack of access to the information in the hands of the businesses which could be the key to proving damage and causation, as has been seen in recent litigation.[10] Thus, the Directive Proposal, despite containing provisions offering access to effective reparation, does not consider the asymmetry of resources and the main obstacles that an affected person must overcome in bringing a civil liability action against a company for violations of human rights and environmental damage.[11].

NEXT STEPS AND RECOMMENDATIONS

Keeping in mind the role that European businesses play in the global economy, the much-anticipated proposal by the European Commission for a Directive on mandatory due diligence constitutes an instrument with important potential for preventing and redressing the negative externalities of the global chains of supply and production. The Directive could open the way for other similar international or regional normative developments. However, for this instrument to be a model for others to follow, some of its limitations need to be addressed during the legislative process.

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10. UK, The Supreme Court, Judgment, *Okpabi and others (Appellants) v Royal Dutch Shell Plc and another (Respondents)*, Case ID: UKSC 2018/0068, 12 Feb 2021, [2021] UKSC 3.

11. PIGRAU, A. et al., *Derechos humanos y empresas europeas. Un manual práctico para las organizaciones de la sociedad civil y los defensores de los derechos humanos*, September 2016. CEDAT. Project "Business & Human Rights challenges for cross border litigation in the European Union" (JUST/2013/JCIV/AG/4661).

In accordance with ordinary legislative procedure (Articles 289 and 294 of the Treaty on the Functioning of the European Union), in order to be approved the Directive Proposal will have to be scrutinised by the European Parliament and by the Council, who could approve it or suggest amendments on a first or second reading. The definitive adoption of this Directive can take several months or years if the institutions do not reach an agreement on the text. For this reason, it is recommended that these legislative institutions:

1. Widen the material scope of due diligence obligations to cover holistically the diverse, accumulative adverse impacts that business could cause across the entire spectrum of internationally recognised human rights and the different environmental impacts that they can generate, avoiding a selective and closed list of human rights, international human rights instruments and international instruments on the environment that businesses should respect by exercising due diligence. And especially in the context of conflict.
2. Extend the scope of the Directive in accordance with the international instruments on responsible corporate conduct, bearing in mind the principle of proportionality that implies that the magnitude and complexity of the means that businesses have at their disposal for assuming responsibility for due diligence can vary according to those factors and according to the severity of the adverse consequences that their activities have on human rights and the environment. At a minimum, consideration should be given to widening the scope to include all large enterprises and SMEs that are listed.
3. Ensure that businesses adopt due diligence policies at the highest management level, that such policies are made public and disseminated internally to all staff, partners and other stakeholders.
4. Include provisions that enable substantive consultations to be held with potentially affected groups and other stakeholders for identifying the actual and potential adverse impacts on human rights and the environment.
5. Reinforce the capacity of leading businesses to exercise or increase their influence to prevent potential or actual adverse human rights and environmental impacts with operations, products or services provided to the other entities with which they have business relationships.
6. Require that the complaints mechanisms that business must implement comply with the criteria contemplated by the UNGPs and that they are empowered and able to provide or cooperate in reparation for the identified potential or actual adverse impacts.

7. Expand the Directive's scope of application to all levels of the value chain, above all to those levels where the adverse impacts to human rights and the environment occur, thereby bringing the Directive into line with the UNGPs, which make no reference to any kind of business relationship.
8. Establish certain parameters for national supervisory authorities in relation to effective, proportionate and deterrent sanctions to be applied in the event of a violation of the due diligence obligations.
9. Consider the exclusion of businesses from public procurement where such businesses have breached their due diligence obligations, modifying, if need be, Directive 2014/24UE of 26 February 2014, on public procurement.
10. Integrate criminal liability of businesses as an instrument of deterrence from causing serious adverse impacts on human rights and the environment.
11. Under the regime of civil liability, include provisions that reverse the burden of proof in cases where it is necessary to obtain information that is in the possession of the businesses in order to establish damage and causation.
12. Address and reduce the practical and legal obstacles (legal aid, translation of documents, collective actions, injunctions, among others) that affected persons must overcome to get effective access to reparation for damage and loss suffered as a result of the actual and potential adverse impacts.

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