STATE OF PLAY ON THE EU’S CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE: FIVE KEY TAKEAWAYS

On 23 February 2022, the European Commission (the Commission) published its proposal for a Corporate Sustainability Due Diligence Directive (CSDD Directive), which requires large companies to identify and address negative human rights and environmental impacts in line with key international frameworks including the UN Guiding Principles on Business and Human Rights (UNGPs) and the OECD Guidelines for Multinational Enterprises on Responsible Business Conduct (OECD Guidelines) and associated due diligence guidance. On 1 December 2022, the Council of the European Union (the Council) published its General Approach, departing in some key respects from the Commission’s position. The European Parliament (the Parliament), in turn, adopted its own negotiating position on 1 June 2023 proposing numerous amendments. The three institutions began the trilogue negotiations on 8 June 2023 with the aim of reaching a political agreement on the final CSDD Directive by the end of the year.

Below we discuss the following key issues cutting across the three legislative proposals and make recommendations for the ongoing trilogue negotiations:

1. Substantive due diligence
2. Extent of the due diligence obligation
3. Financial institutions
4. Administrative supervision and enforcement, liability and remedy
5. Stakeholder engagement
1. SUBSTANTIVE DUE DILIGENCE

The obligation to conduct due diligence is at the heart of the CSDD Directive. Accordingly, it is critical that the due diligence requirements are designed in a way that encourages meaningful engagement to identify and take steps to address adverse human rights impacts. With a move from the soft law responsibilities set out in international frameworks, such as the UNGPs and the OECD Guidelines, towards the creation of hard law obligations to undertake due diligence, there is a danger that the flexible, risk-based approach to the management of human rights impacts envisaged by these frameworks is supplanted by a “checkbox compliance” approach. There are a number of design features which can mitigate this risk and which should be considered by legislators if the CSDD Directive is to achieve its stated objective of fostering sustainable and responsible corporate behaviour and to anchor human rights and environmental considerations in companies’ operations and corporate governance.

The key elements and general approach to due diligence are common across the three proposals (Article 4). Each requires that companies: put in place a policy framework (Article 5); identify the impacts they (may) have on human rights and the environment (Article 6); take appropriate measures to prevent or bring an impact to an end (Articles 7 and 8); maintain a complaints procedure (Article 9); monitor the effectiveness of due diligence (Article 10); and communicate on their due diligence (Article 11).

What is required in order to undertake due diligence to the standard expected under the CSDD Directive should be sufficiently certain to enable companies to understand their obligations and other stakeholders, such as civil society organisations (CSOs) and Supervisory Authorities established to supervise compliance, to be able to monitor the efforts of companies. There must also be sufficient certainty in order for the accountability and remedy mechanisms set out in the CSDD Directive to be used by stakeholders, including through litigation under the civil liability provision (Article 22), reporting substantiated concerns to a Supervisory Authority (Article 19) or making a complaint under a company complaints mechanism (Article 9).

However, the measure should not be so prescriptive as to promote a compliance-based approach that narrowly focuses on the letter but not the purpose of the law. The actions that a company takes in order to address its impacts must be context specific and designed in a manner which will effectively address a company’s identified impacts.

One means of achieving this balance is the definition of “appropriate measures” a company should take to address impacts and the factors which should be taken into account when designing such measures. The Council’s and the Parliament’s positions differ in a few key respects here. Each of the proposals define...
“appropriate measures” to be “measures which are capable of achieving the objectives of due diligence” but the Parliament introduces an additional requirement that the measure be capable of “effectively” addressing the impact. This is an important addition as it encourages the design of measures which are targeted at effectively addressing the impact, rather than being focused on compliance. The German Supply Chain Act (see Section 4(2) Lieferkettengesetz) includes a similar effectiveness requirement, which has proven important in safeguarding against a narrow compliance focused approach, for example, by ensuring that contractual provisions are used to support effective due diligence efforts rather than shifting the obligation or cost burden on to counterparties.

Each of the proposals includes a list of actions that a company may take in order to address impacts (Articles 7(2) and 8(3)). These range from developing prevention or corrective action plans, providing support to those with whom the company has a business relationship, using contractual cascading and verification, to making investments or other adjustments to management or production processes.

The Parliament proposal also includes consideration of the effects of purchasing practices, and the impacts that a company’s business model and strategy have on human rights, as well as a more expansive approach to engagement with business partners beyond the provision of financial and administrative support. Each of these are important additions consideration of which can have a significant impact on a company’s approach to addressing human rights impacts.

It is critical that companies consider a broad range of context specific actions if their efforts to address their human rights impacts are to be effective. As we have commented previously, some companies have “developed more innovative practices to identify and address their human rights impacts, drawing from methodologies such as promoting the use of human rights impact assessments, empowering trade unions and civil society, making investments in management or production processes and creating business models which better respect human rights, encouraging long term collaboration and capacity building with partners and collective responses including working at the sectoral level. Care must be taken to ensure that the requirements of the proposal support these practices and do not perversely encourage a step back.”

To address this concern, it is important that the list of actions which a company may take to undertake due diligence in Articles 7(2) and 8(3) be non-exhaustive. A closed list has the potential to stifle innovation and to encourage a compliance rather than a risk-based approach to due diligence. A company will not be insulated from criticism if it undertakes all specified actions on a closed list if these actions are not sufficient to effectively address its human rights impacts.
In addition, when determining what appropriate measures to take, the Council’s and the Parliament’s proposals demand that companies consider how they are involved in an impact, i.e. whether they (may) cause, contribute or be directly linked to it. These types of involvement derive from the UNGPs, although the degree of detail and alignment with this involvement framework differs across the proposals. It is important that the substantive due diligence articles make clear that when determining what appropriate measures to take, companies are required to consider not only impacts which they cause, but also those to which they contribute, whether by causing an impact jointly with other actors, or facilitating or incentivising another entity to cause an impact through, for example, their purchasing practices. The substantive due diligence articles should also clarify that, when determining what appropriate measures must be taken to affect change in entities causing or contributing to an impact to which companies are directly linked, companies should consider their leverage.

Lastly, stakeholder engagement is one of the most critical means of ensuring that effective approaches to due diligence are adopted. By consulting with stakeholders, especially rightsholders who might be affected, at each stage of the due diligence process, companies can more effectively identify the impacts they may have on human rights and design appropriate measures to adequately address them. The differing approaches to stakeholder engagement between the proposals are outlined in section 5 below.

Recommendations:
The substantive due diligence obligations should encourage to the greatest extent possible a risk-based approach to due diligence, requiring companies to develop appropriate measures which are context specific and designed to be effective. Every possible effort should be taken to avoid a checkbox compliance approach. This includes:

- incorporating effectiveness criteria in the definition of appropriate measures;
- including a non-exhaustive list of actions a company should take to address impacts in order to promote an effective, risk-based approach to due diligence which does not stifle innovation;
- ensuring that companies consider not only impacts which they cause, but also impacts to which they contribute or are directly linked when determining what appropriate measures to take; and
- emphasising the critical role of stakeholder engagement throughout the due diligence process, including in designing effective measures.

2. EXTENT OF THE DUE DILIGENCE OBLIGATION

Business-related human rights impacts can take a range of forms and occur not only in the supply chain or in association with a business’ own operations, but
also after a product or service has left a company, often referred to as the “downstream” part of the value chain. This can involve the provision of goods and services to end-users and consumers, how these goods and services are used by other companies or governments, as well as conditions for workers in distribution and logistics or impacts associated with end-of-life disposal of products. As recently noted by OHCHR, omitting the downstream part of the value chain can lead to severe human rights impacts not being properly considered by a company. In some industries, the downstream value chain may carry more severe human rights risks than the upstream supply chain. The impact of the use of technology on the enjoyment of rights is a clear example.

Recognising this, the Commission proposal extends a company’s obligation to conduct due diligence across the full value chain, meaning that companies would be required to consider not only impacts that arise in the context of their supply chain, but also in the “downstream” part of the value chain (at least in relation to established business relationships). However, Council and Parliament have taken more restrictive approaches to due diligence in the downstream part of the value chain, limiting its scope to certain activities which include distribution, transport, storage and disposal as well as waste management in an effort to exclude the use of products or services.

Yet, the Parliament proposal importantly includes “sale” in the definition of the downstream value chain and further introduces requirements in Articles 7(2a) and 8(3a) for companies to consider the composition, design and commercialisation when selling or distributing a product or service. Companies should be required to consider these matters as part of the due diligence conducted on their own operations, while recognising that these elements will be relevant to how a product or service may impact human rights after it leaves the company. In order for a company to properly assess the actual and potential impacts of the manner in which a product or service is designed, brought to market and composed, and to develop appropriate measures to address such impacts, a company will necessarily have to consider the actual or potential uses of its products or services.

Recommendations:
It is vital that the scope of due diligence that a company is required to undertake include impacts which arise in the downstream part of the value chain. Omitting downstream activities can lead to severe human rights impacts not being properly considered by a company and would substantially exclude sectors where the downstream value chain may carry more severe human rights risks than the upstream supply chain.

The use of a company’s products or services is a critical component to be considered in order for a company to properly identify and address the impacts that their products and services may have after they leave the company. The
requirement to consider the impacts which may arise from the sale, composition, design or commercialisation of a product or service is one means by which these use considerations can be incorporated into a company’s due diligence and should be included in the final CSDD Directive.

3. FINANCIAL INSTITUTIONS

A key issue in the trilogue negotiations is the extent to which the CSDD Directive should apply to the financial sector. All three legislative proposals define a “company” to include certain financial institutions within scope, such as credit institutions and investment firms. However, compared to real economy companies the different proposals take a narrower approach to due diligence. For instance, the scope of due diligence financial institutions must undertake is limited to the activities (and due diligence practices) of direct business partners, i.e. legal entities directly receiving financial services and subsidiaries linked to the contract in question.

The Council’s approach is the most restrictive as Member States (MS) are given discretion whether or not to include financial institutions in scope of the Directive (see Article 2(8)). This carries the risk of fragmentation across MS and fails to facilitate the creation of a level playing field, one of the stated objectives of the Directive. Further, when it comes to the financial sector specifically, the Council text follows the Commission proposal and requires that adverse impacts are identified only at the “pre-contract” stage. Under the Parliament proposal, by contrast, adverse impacts must also be identified prior to subsequent financial operations or when notified by a complaints mechanism, recognising that financial institutions can have impacts and exercise leverage over their business partners throughout a business relationship.

Moreover, the Council’s and the Parliament’s texts differ in their treatment of investment activities. The Council excludes investor-investee relationships from the scope of the Directive, while the Parliament covers investment activities and introduces a new provision (Article 8a), which specifies what institutional investors and asset managers must do to address actual impacts caused by investee companies, such as exercising voting rights.

In addition, there is a conceptual difference between the proposals on how a financial institution can be involved in an adverse impact, i.e. whether it may cause, contribute or be directly linked to it (UNGPs involvement framework). While it has been suggested that financial institutions may only be directly linked to impacts through their business relationships, this viewpoint has been rejected by John Ruggie and authoritative guidance on HRDD for financial actors. The involvement framework exists on a continuum, and the current consensus is that financial actors may also cause or contribute to an impact. While the Commission and the Council do not address the question of involvement, the Parliament’s text
introduces a presumption that financial institutions can only be directly linked to an adverse impact in their value chain. It is unclear whether this presumption is rebuttable. In the case of financial institutions, taking too narrow a view by presuming that such actors can only be directly linked to an impact risks stifling the development of emerging practices among financial institutions (see, for example, the 2023 Position Statement on Human Rights by Danske Bank or relevant publications under the Dutch Banking Sector Agreement).

Recommendations:
Given the significance of the financial industry in contemporary economies, it is crucial to include financial institutions in the scope of the CSDD Directive and to harmonise their due diligence obligation across the EU. In line with international standards, financial institutions should undertake due diligence throughout their economic activities, including in respect to the provision of financial services and investment activities. To account for the particularities of investor-investee relationships, the EU legislator may specify what measures are appropriate in this specific context.

Further, financial institutions should assess their adverse impacts not only at the precontractual stage, but continuously, for instance, at milestones in a business relationship or following a complaint raised through a grievance mechanism. As financial institution may also cause or contribute to harm, the presumption proposed by the Parliament, according to which financial institutions are only linked to adverse impacts, should be abolished or, as a minimum, made rebuttable.

4. ADMINISTRATIVE SUPERVISION AND ENFORCEMENT, LIABILITY AND REMEDY

Ensuring that the obligation to undertake due diligence is effectively enforced is a critical component of the CSDD Directive. The EU legislators all propose a combination of public supervision and enforcement through Supervisory Authorities and a civil liability mechanism. Both regimes provide avenues to hold companies that do not comply with their due diligence obligation to account. Companies must also facilitate access to remedy themselves through complaint handling mechanisms (Article 9).

Under all proposals, public supervision and enforcement falls in the competence of Supervisory Authorities at the MS level, which would be supported by a European Network of Supervisory Authorities (Article 21(1)). Supervisory Authorities can investigate cases of non-compliance and order companies to meet their due diligence obligation, impose sanctions, and take interim measures (Articles 17, 18 & 20). Each proposal further allows natural and legal persons to submit substantiated concerns to a Supervisory Authority if they have reasons to believe that a company is failing to comply with its due diligence obligation (Article 19). Differences between the proposals emerge regarding the scope of
responsibilities assigned to Supervisory Authorities. The Parliament text introduces new competences, such as the power to assess how companies prioritise adverse impacts (Article 18(5)(ca)). It further extends the list of considerations that determine whether and how a company may be sanctioned as well as the repertoire of sanctions Supervisory Authorities have at hand. Importantly, it also imposes obligations on Supervisory Authorities to publish lists of companies required to comply with the Directive (Article 18(7a)), to keep records on investigations and remedial actions (Article 18(7b)), and to publish and make available annual reports (Article 17(8a)) – each of which is key to ensure that CSOs, national Human Rights Institutions and other stakeholders can properly monitor how Supervisory Authorities are overseeing compliance.

Each proposal includes a **liability mechanism** by which companies can be sued for damages caused by failures to meet their due diligence obligation, although the proposals differ in their formulations. On the Council’s approach, companies can only be liable where they intentionally or negligently caused a harm to a protected interest under national law, meaning that MS will not be required to create additional categories of damage to those existing under their national legal systems. In contrast, the Commission and the Parliament neither require intention or negligence nor a limitation to protected interests. In addition, the Parliament proposes several additions to address access to justice issues including reasonable costs for claimants, minimum limitation periods, the possibility of legal representation of victims by trade unions or CSOs, and easier access to evidence held by a defendant (Article 22(2a)), recognising the obstacles claimants may face when seeking remedy.

It is important for any liability mechanism to be designed in a balanced manner which does not create unnecessary obstacles for prospective claimants. The liability mechanism should hence be **clear and concise**, allowing for liability for harms which occur as a result of a failure to conduct due diligence to the standard required by the Directive rather than including additional elements which could give rise to unnecessary hurdles for those seeking remedy.

All proposals require that companies engage in **remediation** where a harm has occurred. The Commission and the Council handle remediation in the provision on managing actual adverse impact (Article 8(3)(g)), whereas the Parliament introduces a dedicated article (Article 8c), which specifies that remediation must aim to restore the affected person’s situation, which can take the form of restitution, rehabilitation, public apologies, reinstatement, a contribution to investigations, and prevention of further harm. It is important to emphasise the critical role of remediation and clarify that remediation can take a range of forms.

**Recommendations:**
- Supervisory Authorities should be afforded a broad range of powers to allow for effective interventions to ensure compliance with the CSDD
Directive. Supervisory Authorities should also be required to facilitate monitoring of compliance by other stakeholders through practising transparency by publishing the names of companies required to comply with the Directive and by reporting annually about their own work.

- The liability mechanism in the CSDD Directive should be clear and concise allowing for liability for harms which occur as a result of due diligence failures.
- The Directive should emphasise the need for companies to remediate and clarify that remediation can take different forms.

5. STAKEHOLDER ENGAGEMENT

As noted above, engagement with stakeholders and particularly with rightsholders is one of the most critical means of ensuring that the actions that a company takes to address its human rights impacts are developed in a way that is effective and meets the needs of individuals and communities affected.

The legislative proposals take diverging approaches on the extent to which companies should engage with stakeholders throughout the due diligence process.

The Commission Proposal defines stakeholders focussing on employees and other individuals, groups, communities and entities affected. Extending this definition, the Council adds references to specific actors, including trade unions, consumers, CSOs and human rights and environmental defenders. A more differentiated approach is taken by the Parliament, which distinguishes between “affected stakeholders” (Article 3(1)(n)) and “vulnerable stakeholders” (Article 3(1)(na)). The former include individuals, groups and communities whose rights or legitimate interests may be affected (also referred to as “rightsholders” in international frameworks such as the OECD Due Diligence Guidance), their “legitimate representatives” and “credible and experienced organisations” working on the protection of the environment. “Vulnerable stakeholders”, in turn, form a subcategory of individuals that are particularly exposed to adverse impacts, such as indigenous peoples, and whose interests demand particular attention in stakeholder engagement processes (Articles 5(2b) and 8d(7)).

The Council only requires stakeholder consultations in the development of preventive or corrective action plans (Articles 7(2)(a) and 8(3)(b)) and “due consideration” of stakeholder input in the revision of companies’ due diligence policies (Article 10(1)). When identifying adverse impacts (Article 6(4)), companies shall further involve stakeholders “where relevant”, meaning that companies have some margin of discretion. The Parliament, by contrast, introduces a new provision (Article 8(d)) dedicated to meaningful engagement with affected stakeholders. Under this article, companies must consult affected stakeholders at each stage of the due diligence process and provide them with


relevant information. Affected stakeholders are also empowered to file a request for written information, which must be handled within a “reasonable amount of time” (Article 8(d)(4)). When consulting or informing affected stakeholders, companies shall address practical hurdles to engagement and ensure that stakeholders are not subjected to retaliation or retribution.

In line with international standards and authoritative guidance, stakeholder identification and engagement should be an integral part of human rights and environmental due diligence. The involvement of stakeholders and particularly rightsholders in the CSDD Directive should take place throughout the due diligence process and on an ongoing basis. Moreover, stakeholder engagement is not a one-way street that only provides companies with input. It also demands proactive disclosures of relevant information to affected stakeholders.

**Recommendations:**
Engagement with stakeholders and particularly with rightsholders should be embedded throughout the due diligence process requiring not only engagement in order to properly identify impacts and determine appropriate measures, but also proactive communication and the provision of relevant information.
END NOTES


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