

ENNHRI Statement on the proposal for a Corporate Sustainability Due Diligence Directive

April 2023

Executive Summary

The European Union is currently drafting a directive on Corporate Sustainability Due Diligence (CSDD Directive). The legislative process involves the European Commission, the Council of the European Union, and the European Parliament.

On 23 February 2022 the European Commission published its [proposal for a Corporate Sustainability Due Diligence Directive](#) which requires large companies to identify and address their negative human rights and environmental impacts in line with key international frameworks, including the UN Guiding Principles on Business and Human Rights (UNGPs) and OECD Guidelines for Multinational Enterprises (OECD Guidelines), and associated due diligence guidance.

In March 2022, ENNHRI published a [statement](#) in response to the European Commission's proposal, stating that the proposal had the potential to have a significant positive impact for people and the environment.

On 30 November 2022 the Council of the European Union published its [general approach](#), which differs in some key respects from the Commission's position.

As of March 2023, negotiations on the European Parliament's position on the proposed CSDD Directive are still underway, but early indications of the direction of travel have been given by the [draft Report from the Committee on Legal Affairs](#), published on 7 November 2022.

ENNHRI notes important deviations by the Commission's proposal and the Council's general approach from international business and human rights frameworks and best practice as already undertaken by economic actors in developing and implementing environmental and human rights due diligence. These departures from existing instruments could create legal uncertainty for

businesses, especially when many have already taken steps in implementing international standards, such as the UNGPs and the OECD Guidelines. There is an additional risk that the proposal misses the opportunity to fill in the gaps between existing instruments in a meaningful way by effectively enhancing the protection of human rights and the environment across global value chains.

In this context, ENNHRI recommends that European institutions utilise the opportunity during trilogue to adopt a broader approach to due diligence that is based in existing international instruments and best practice standards as already taken up by economic actors.

ENNHRI makes the following comments on the Council of the European Union's general approach:

1. **Personal scope:** The scope of the proposed CSDD Directive should be broadened to include financial institutions, and these should be required to undertake due diligence in an ongoing manner.
2. **Extent of the due diligence obligations:** The CSDD Directive should take a full value chain approach by setting due diligence requirements covering both the upstream and downstream parts of the value chain.
3. **Duty of directors:** The CSDD Directive should include a clear duty of directors and businesses' governance structures to commit to the due diligence process and acknowledge the responsibility to respect human rights.
4. **Material scope (Annex I):** The scope of environmental instruments detailed in Annex I of the CSDD Directive (to be covered by the due diligence process) should be reviewed and potentially extended.
5. **Substantive due diligence:** The CSDD Directive should clarify that while multi-stakeholder initiatives, third-party verification mechanisms, and contractual assurances can be useful in the due diligence process, they should only be considered as one element of a comprehensive due diligence approach.
6. **Stakeholder consultation:** The CSDD Directive should provide for meaningful stakeholder consultation and engagement throughout the due diligence process, including at the strategic and design level. However, this should not shift the burden of conducting

thorough due diligence onto stakeholders, when this should be the responsibility of companies and use companies' resources.

7. **Civil liability and remedy:** In addition to clarifications on prerequisites of civil liability made by the Council, the CSDD Directive should consider and address procedural hurdles faced by victims seeking redress for business-related human rights abuses to ensure an effective access to remedy. The CSDD Directive should also have a broad approach to remedy, beyond only financial compensation.

Detailed Overview

1. Personal scope: financial institutions

The Council's general approach followed the Commission's proposal in terms of the scope of companies which the proposed directive would cover, but introduced a phase-in approach whereby the proposal's provisions would first only apply to very large companies that have more than 1000 employees and EUR 300 million net worldwide turnover, or 300 million net turnover generated in the EU for non-EU companies. It added that the threshold criteria stated in the proposal would have to be met for two consecutive years (Art. 2).

The Council's general approach most notably departs from the content of the Commission's proposal in terms of personal scope lies with the Council's exclusion of specific financial institutions. The Commission's proposal defined companies to include "regulated financial undertakings", such as credit institutions, investment companies and funds, while the Council's general approach reduces the scope of regulated financial undertakings to exclude financial products and undertakings for collective investment in transferable securities.

The Council's general approach also provides an option for Member States to exclude pension institutions that are social security schemes from the scope of the directive. Moreover, the Council proposes that, should a Member State decide to apply the proposed CSDD Directive to the financial services provided by regulated financial undertakings, these regulated financial undertakings would only be required to identify the adverse impacts in the operations of their business partners only before providing the financial service (Art. 6(3)), thereby exempting these from having to monitor adverse impacts caused by business partners. Regulated financial undertakings will also be exempt from temporarily suspending or terminating business relationships where adverse impacts have been identified and not successfully addressed (Arts. 7(6) and 8(7)). In practice, this will lead to the effective exclusion of the financial sector.

This exclusion goes against the approach taken by international business and human rights standards, such as the UNGPs, which call on all businesses, including financial actors, to conduct due diligence. The Council's approach would mean that, under the CSDD Directive financial institutions could not be held liable for potential adverse human rights impacts occurring through business activities for which they have provided finance.

ENNHRI encourages institutions engaged in trilogue negotiations to include all financial institutions within the scope of the CSDD Directive. ENNHRI also recommends that financial institutions be required to undertake an ongoing due diligence process, including after having provided financial services. More broadly, ENNHRI recommends that the personal scope not be narrowed as it moves away from both the UNGPs and best practice.

2. Extent of the due diligence obligations: “established business relationship” and value chain

The Commission's proposal provides for 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.

The Commission's proposal, however, delimits the scope of value chain due diligence by reference to the concept of an “established business relationship” (EBR). This has been remarked on not only in [ENNHRI's statement](#) on the Commission's proposal, but also by a broad range of stakeholders from business to civil society. Although the term EBR was intended to create legal certainty by placing a limit on the scope of due diligence, in fact ambiguities in the definition resulted in a lack of clarity as to which business relationships would be included and accordingly how far the due diligence obligation would extend. Limiting the scope of due diligence by reference to EBRs creates the potential for important human rights impacts to be missed during the due diligence process, and for businesses to restructure their relationships to avoid the due diligence obligation.

The Council's general approach removes the EBR concept, but instead restricts the scope of due diligence from the value chain to a company's “chain of activities”. The definition of the “chain of activities” concept is a novel concept which is imprecise and contains a range of ambiguities. The “chain of activities” concept covers the supply chain and selected downstream impacts, leaving out the phase of the use of a product or service (Art. 3(g)). The exclusion of downstream impacts in due diligence processes fails to account for the responsibility of businesses to respect human rights through their relationships with business partners across the full value chain. Cases of

human rights abuses in the downstream value chain have increasingly been receiving media attention, sometimes leading to court litigation. There is currently only limited guidance regarding due diligence on the downstream; clear regulation setting out expectations for companies to address and remedy those impacts is therefore critical to ensure respect for human rights. This is especially concerning in light of the steps already taken by leading companies in conducting human rights due diligence in the downstream part of the value chain.

Accordingly, similar criticisms to those levelled at EBR can be applied to the chain of activities concept.

ENNHRI recommends that the European Parliament clearly establishes that due diligence obligations cover the entire value chain, including the phase of the use of the product or service, as this stage of the value chain has potential for having critical impacts on human rights and the environment.

In its last statement commenting on the Commission's proposal, ENNHRI recommended that the proposed CSDD Directive should take a risk-based approach to due diligence, in line with the UNGPs and OECD Guidelines. ENNHRI welcomes the introduction of a new provision by the Council, providing for the prioritisation of identified impacts on the basis of severity and likelihood of the adverse impact in line with international standards.

3. Duty of Directors

The Commission's proposal introduced a responsibility for directors to oversee the due diligence process by setting out a duty of care which states that directors shall take into account the consequences of their decisions for sustainability matters including human rights, climate change and the environment in discharging their duty to act in the best interests of the company. This inclusion in the Commission's proposal was already limited in its language and only imposing an obligation of means to commit to a due diligence process. However, answering to concerns related to the duty of directors being a concept that interferes with corporate governance, the Council's general approach removed the directors' duties, arguing that the proposed CSDD Directive should not interfere with the company's governance and structure by affecting the form and structure of directors' remuneration.

The Council's approach to the duty of directors is contrary to international frameworks like the UNGPs, which require a clear acknowledgement to respect human rights and conduct due diligence. **ENNHRI encourages European institutions to include a clear duty of directors and businesses' governance structures to commit to the due diligence process and acknowledge the responsibility to respect human rights.**

4. Material scope – Annex I

The Council's general approach contains a list of specific rights and prohibitions that can be observed both by states and companies and that in case of violation or abuse constitute adverse human rights or environmental impacts in Annex I. It refers to international human rights and environmental instruments that are ratified by – and therefore binding – for all Member States. Regarding environmental instruments, ENNHRI welcomes those clarifications, but at the same time notes that the list of referenced instruments should be reviewed and amended to better comply with EU efforts on environmental protection as addressed, for instance, by the European Green Deal.

5. Substantive due diligence: contracts and group due diligence

Contractual measures are part of substantive due diligence obligations in the Commission's proposal. Companies can be required to use them to prevent potential adverse impacts (Art.7), as well as bringing adverse impacts to an end (Art. 8). For both, the Commission's proposal states that companies should use contractual assurances with direct business partners to give legal weight to a company's code of conduct and help ensure compliance with the code. The Council's general approach keeps reference to direct business partners but limits the scope to company's chain of activities, which supposedly leans more towards the concept of upstream supply chain, than to the full value chain as proposed by the Commission. In line with the Commission's proposal, the Council kept reference to the company's obligation to verify compliance with contractual measures and refers to suitable industry initiatives or independent third-party verification mechanisms, such as certification schemes. While industry and multi-stakeholder initiatives and third-party verification mechanisms can be useful in the due diligence process, these have well documented shortcomings and should only be considered as one element of a comprehensive due diligence approach.

Moreover, while innovative approaches for collaborative leverage should be encouraged, **ENNHRI recommends that industry and multi-stakeholder initiatives hold their members accountable and involve affected stakeholders in their work or governance structures.** Such initiatives can only support, but never replace, a company's own due diligence responsibilities, including potential liability. The same applies to outsourced third party certification schemes.

The Council furthermore introduces a provision covering due diligence at group level (Art. 4(a)), stating that the parent company may be required to undertake due diligence on behalf of its subsidiaries. The possibility for the parent company to fulfil due diligence obligations is subject to

several conditions. The proposal explicitly states that civil liability of subsidiaries would not be affected by group due diligence measures. ENNHRI welcomes this clarification.

6. Stakeholder consultation

In line with the Commission's proposal, the Council's general approach only provides for a limited role for stakeholder consultations and no explicit prioritisation on rightsholder consultations. The Council's general approach still does not provide for a mandatory consultation in the risk assessment, keeping the ambiguous term "where relevant" from the Commission's proposal. It likewise does not foresee a role for stakeholders in the design of the due diligence policy (Art. 7) or of remedial measures (Art. 8 para 3(a)). It adds that the outcome of the monitoring phase should lead to an update of the due diligence policy with due consideration of relevant information from stakeholders (Art. 10). It adds that when developing model contractual clauses, the Commission should do so in consultation with both Member States and stakeholders (Art. 12).

ENNHRI welcomes further explicit inclusions of stakeholders throughout the due diligence process, but notes that the directive should provide for more effective stakeholder participation at strategic stages of the due diligence process, including the design of the due diligence policy. The recommendation to include more meaningful stakeholder consultations throughout all steps of the due diligence process was reflected in the [draft report](#) of the Committee on Legal Affairs. Stakeholder identification and engagement should be an integral part of a company's human rights due diligence, but should not lead to an overreliance on stakeholders with limited resources to be heavily relied on during the due diligence process for companies. The existing provisions carry a risk of shifting the burden of conducting thorough due diligence onto stakeholders, when this should be the role of companies and use companies' resources.

7. Civil liability and remedy

The Council's general approach on civil liability (Art. 22) provides further legal clarity by determining four conditions for civil liability, namely damage caused by a natural or legal person, a breach of duty, the causal link between damage and breach of duty and a fault. The Council's general approach does not foresee any reliance on contract clauses. The Commission's proposal on civil liability, in contrast, foresaw that companies would not be liable for failing to prevent or cease harm at the level of "indirect business relationships" if they reasonably used contract clauses to secure responsible business conduct from partners and put in place processes to monitor compliance.

Reliance on contracts to avoid liability would create loopholes which could undermine the effectiveness of the proposal. Therefore, ENNHRI particularly welcomes the fact that civil liability is

no longer linked to safeguards for companies that sought contractual assurances or other safeguard proposals.

Further, the Council provides clarifications of the joint and several liability of a company and a subsidiary or a business partner and the overriding mandatory application of civil liability rules. ENNHRI welcomes these clarifications which will assist with the implementation of the CSDD Directive on the national level.

However, ENNHRI reiterates its encouragement to the European Parliament to grasp the opportunity of the drafting of this directive to better consider the recommendations made, *inter alia*, by the [European Union Agency for Fundamental Rights](#) on how to overcome the numerous hurdles, such as the burden of proof or disclosure during court proceedings, faced by victims seeking redress for business-related human rights abuses.

In a similar way to the Commission's proposal, the Council's general approach remains conservative with regards to the role of companies in providing remedy for adverse human rights and environmental impacts, in comparison to existing international standards. The Council's general approach only reiterates that companies may be required to provide full financial compensation in case of such impacts—so long as it does not lead to any form of “punitive damages”, or “overcompensation” (Art. 22(2)). International human rights standards provide for a broader and more effective approach to remedy, in line with international human rights standards. For example, the UNGPs provide that a company should play a larger role in providing remedy, including by cooperating in a broader range of remedies, going beyond financial compensation. In particular, the UNGPs state that remedy “may include apologies, restitution, rehabilitation, financial or non-financial compensation and punitive sanctions (whether criminal or administrative, such as fines), as well as the prevention of harm through [...] injunctions or guarantees of non-repetition.” ENNHRI reiterates its encouragement for legislators to adopt an approach to remedy and compensation that is in line with these international standards.