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**PROPOSAL FOR A EUROPEAN DIRECTIVE ON CORPORATE SUSTAINABILITY
DUE DILIGENCE: TOWARDS A STRENGTHENING OF THE LEGAL REGIME
FOR CORPORATE SOCIAL AND ENVIRONMENTAL BEHAVIOUR**

PROPOSAL FOR A EUROPEAN DIRECTIVE ON CORPORATE SUSTAINABILITY DUE DILIGENCE: TOWARDS A STRENGTHENING OF THE LEGAL REGIME FOR CORPORATE SOCIAL AND ENVIRONMENTAL BEHAVIOUR



A European corporate sustainability due diligence was agreed upon on December 14th, 2023. As part of the European trilogue initiated in September 2023, the European Parliament and the Council have reached a provisional agreement after a night of negotiations on the proposed EU directive on corporate sustainability due diligence.

This proposal, mainly inspired by the French Duty of Vigilance Act adopted on March 27, 2017, aims to mandate large companies within the EU to identify and prevent negative social and environmental impacts arising from their activities across their entire value chain.

The current draft proposed by the European institutions defines the scope of the companies that will be concerned, specifies the rules governing their obligations, and clarifies the sanctions and conditions of civil liability for companies that fail in their duty of care.

The compromise text already introduces the challenge for in-scope companies to integrate corporate sustainability due diligence into their business strategy.

More comprehensive and far-reaching than the French law, whose effectiveness has yet to be confirmed, the proposed European directive on corporate sustainability due diligence (known as the Corporate Sustainability Due Diligence directive, or "CSDDD"), introduced by the European Commission on February 23, 2022, aims to require large businesses to promote sustainable and responsible behaviour throughout global value chains. The Council and the European Parliament adopted their positions on this proposal on December 2, 2022, and June 1, 2023, respectively. On December 14th, 2023, a compromise text has been reached. The text should be formally adopted in 2024, enter into force into domestic law within two years of the end of the transposition period, and apply with a time lag depending on the type of company concerned as per the agreed text.

In view of its implications for companies, this proposal deserves particular attention. It put forward a better framework for the legal responsibility of companies within the European Union (EU) to manage human rights and environmental impacts arising from their activities, as well as those of their subsidiaries and business partners.

Once adopted, the CSDDD will entail a major transformation of companies' compliance practices, including for French companies already subject to the 2017 law. In-scope companies will have to update their procedures to map out risks, prevent and mitigate actual and potential adverse impacts at all levels of their supply chain, to amend existing contracts and to prepare new contractual provisions to comply with the directive requirements.

These new obligations challenge the undertakings' ability to comply with the CSDD and could be a major source of legal and litigation risks. Companies are called upon to anticipate proactively the implementation of this European corporate sustainability due diligence as early as possible.

The key points of the proposed directive are set out below.

1. THE SCOPE OF THE EU'S CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE

1.1 . Harmonization on a European scale

Although controversial, but groundbreaking at global level, the French Duty of Vigilance Act (law n°2017-399) relating to corporate sustainability due diligence dated on March 27, 2017, known as the "Rana Plaza law", was undoubtedly a major source of inspiration for the proposed European directive. Since its introduction, several States have sought to introduce similar regulations such as Germany, Netherlands, Spain, or, outside the EU, Norway and Switzerland, and have chosen to legislate in scattered order, while others have remained silent on this topic.

The directive aims to prevent legal fragmentation across the EU for companies operating in several Member States, as the measures adopted vary from one State to another, and to meet the expectations of both consumers and investors, who are keen to give preference to products made in a sustainable way.

Within this backdrop, and in line with the guidelines on corporate sustainability due diligence issued by the United Nations and the OECD, it appeared necessary to strengthen and harmonize practices at European level for consistency, and to define a uniform and binding European legal framework to create a fair level playing field.



1.2. Scope of application

According to the provisional agreement, companies in scope would be:

- group 1: all EU companies of substantial size and economic power with 500+ employees and EUR 150 million+ in net turnover worldwide;
- group 2: other companies with more than 250 employees and a net turnover of EUR 40 million worldwide and more operating in defined high impact sectors (textiles, agriculture and extraction of minerals), and for which rules will start to apply two years later than for group 1;
- non-EU companies active within the EU with a net turnover of EUR 40 million, generated in the EU.

This scope of application, which is much broader than that the French law one (whose threshold is 5,000 employees for companies established in France, and 10,000 employees for foreign companies operating in France), target 11,900 European companies - including 1,582 French ones - and 6,000 non-European companies operating within the EU.

Given the system's thresholds, small and medium-sized enterprises (SMEs) would not be directly concerned by the European corporate sustainability due diligence, unless they are involved in the value chain of a company subject to the law as a subsidiary or a business relationship, or if they decide to submit to it on a voluntary basis.

In order to unblock negotiations, the Parliament and the Council granted an exemption to the financial sector (i.e. banks, insurers and asset managers). At least temporarily. There lies the compromise, with a review clause allowing the sector to be included at a later stage.

1.3 . Purpose of the European mechanism

The proposal will require in-scope companies to undertake the appropriate measures to prevent and mitigate potential adverse impacts, and to put an end to actual negative impacts or minimize their extent, in their own operations and those of their subsidiaries, as well as those of business partners with whom they have "established business relationships" in their value chains (suppliers, subcontractors, etc.). These negative impacts are defined as those resulting from the violation of international conventions contained in an annex. This covers the entire "chain of activities", a term preferred by the Council to "value chain", but which excludes most of downstream activities.

The directive would also require companies to set up a climate transition plan designed to ensure that the company's business model and strategy are compatible with the requirements of the Paris Agreement (which does not appear on the list of conventions to be respected) to limit global warming to 1.5°. The nature and the scope of this obligation will have to be specified in the final version of the directive.

2. THE CONTENT OF THE EU LEGAL FRAMEWORK

2.1. Companies' duties

Inspired by French law, the proposal states that companies should comply with the six following mandatory measures:

- Integrate due diligence into policies;
- identify actual or potential adverse human rights and environmental impacts;
- prevent or mitigate potential impacts;
- bring to an end or minimise actual impacts;
- establish and maintain a complaint procedure;
- monitor the effectiveness of the due diligence policy and measures;
- and publicly communicate on due diligence.

The current draft of the proposal stipulates that stakeholders could be consulted to gather information on actual or potential negative impacts, and to take part in drawing up due diligence measures.



2.2. The implementation of the corporate sustainability due diligence

To monitor the implementation of corporate sustainability due diligence, national administrative authorities will be designated to supervise compliance by in-scope companies, with powers of investigation and administrative sanction.

Based on French Law, more specifically to articles 1240 and 1241 of the French Civil Code, the proposal stipulates that companies may be held liable in the event of damage resulting from a breach of their duty of care, or the occurrence of damage caused by a negative impact that should have been identified, avoided, mitigated or reduced.

The compromise text also placed obligations on directors, who would be required to set up and to supervise the implementation of corporate sustainability due diligence, and to integrate it into corporate strategy. The directive as finally adopted will clarify this point.

Victims could also take easier civil liability actions for damages before the competent national courts when harms occurred as a result of due diligence failures.

2.3. Sanctions

To ensure effective application of corporate sustainability due diligence, Member States should provide for "effective, proportionate and dissuasive" sanctions, such as public denunciation, withdrawal of a company's products from the market or fines of at least 5% of worldwide sales, in case of non-compliance. Foreign companies subject to the scheme could face exclusion from European public procurement contracts.



The compromise reached by the European Parliament and the Council, whose impact on the compliance practices of the in-scope companies cannot be underestimated, must now be formally adopted by the Parliament and the Council before being definitively adopted.

The Directive will enter into force twenty days after its publication in the EU Official Journal, and Member States will have two years to transpose it into domestic laws.

Companies, both European and foreign, will need to keep a close eye on implementing laws with extraterritorial scope, which may introduce stricter measures than those provided for in the directive.

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