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Towards a European corporate due diligence duty

The European Commission has adopted a proposal for a Directive on corporate sustainability due diligence. Companies will be required to identify and, where necessary, prevent, end or mitigate the adverse impacts of their activities on human rights and the environment.

Background

The European Parliament and the Council of the European Union had called on the European Commission to submit a proposal for an EU legal framework on sustainable corporate governance (the “Proposed Directive”), along the lines of what exists in France^[1] and Germany.

The European Commission’s Proposed Directive responds to these calls, following the launch of an open public consultation on the sustainable corporate governance initiative on October 26, 2020^[2]. In preparing the Proposed Directive, the European Commission also considered the broad base of evidence collected through two commissioned studies on directors’ duties and sustainable corporate governance (July 2020)^[3] and on due diligence requirements in the supply chain (February 2020)^[4].

Purpose

The Proposed Directive lays down rules on:

- obligations for companies regarding actual and potential human rights adverse impacts and environmental adverse impacts, with respect to their own operations, the operations of their subsidiaries, and the value chain operations carried out by entities with whom the relevant company has an established business relationship; and
- liability for violations of these obligations.

As such, it applies to the companies' own activities, those of their subsidiaries, but also to the value chains (direct and indirect established business relationships).

Companies subject to the new obligations

The Proposed Directive would apply to:

- large companies with more than **500 employees** and a net worldwide turnover in excess of **EUR 150 million**;
- companies with more than **250 employees** and a net **worldwide annual turnover in excess of EUR 40 million, provided that at least 50% of this net turnover is generated in one or more specific business sectors** (textile and footwear industry, agriculture, fisheries, manufacture of food products, extraction of mineral resources (petroleum, gas, coal), manufacture of metal products, etc.). For these companies, the new rules would start applying two years after their entry into force;
- companies organized and operating under the laws of a third country when they generate a net annual turnover in excess of **EUR 150 million** in the European Union, or in excess of **EUR 40 million in the European Union when at least 50% of this turnover is generated in one or more of the aforementioned specific business sectors**.

As such, approximately 13,000 European companies and 4,000 companies from third countries operating in the European Union would be subject to the corporate due diligence duty. The scope of application of the Proposed Directive would therefore be broader than that of French law, which only concerns large companies with more than 5,000 employees in France or 10,000 in France and abroad (i.e., approximately 250 companies targeted).

Small and medium-sized businesses (SMBs) do not fall directly within the scope of the Proposed Directive. Nonetheless, the European Commission specified that they *“will, however, be exposed to some of the costs and burden through business relationships with companies in scope as large companies are expected to pass on demands to their suppliers”*.

Obligations

In order to comply with the corporate sustainability due diligence duty, companies would have to (Article 4 of the Proposed Directive):

- Integrate due diligence into their policies and governance;
- Identify actual or potential adverse human rights impacts and adverse environmental impacts;
- Prevent and mitigate potential adverse impacts, and bring actual adverse impacts to an end or minimize their extent;
- Establish and maintain a complaints procedure;
- Monitor the effectiveness of the due diligence policy and measures;

- Publicly communicate on due diligence.

Each of these 6 obligations is then detailed in Articles 5 to 11 of the Proposed Directive.

Liability and sanctions

In case of non-compliance with the above obligations, non-compliant companies may be held civilly liable and required to pay compensation to those affected (Article 22 of the Proposed Directive).

Member States would also have to ensure that companies comply with their due diligence obligations, and would be entitled to impose fines in case of infringement (Article 20 of the Proposed Directive).

A supervisory authority would have to be set up in each Member State with the power to require a company to stop non-compliant behavior or even to sanction it (Article 17 of the Proposed Directive).

Climate change

Companies with more than **500 employees** and a net worldwide turnover in excess of **EUR 150 million** would be required to adopt a plan to ensure that their business model and strategy are compatible with the limiting of global warming to 1.5 °C in line with the Paris Agreement (Article 15 of the Proposed Directive).

The fulfilment of this obligation must be taken into account when setting variable remuneration, if variable remuneration is linked to the contribution of a director to the company's business strategy and long-term interests and sustainability.

Next steps

The Proposed Directive will be submitted to the European Parliament and the Council of the European Union for approval. Once the Directive is adopted, Member States will have two years to transpose it into national law and communicate the relevant domestic pieces of legislation to the European Commission.

[1] See articles entitled [French Climate and Resilience Law: What impact on corporate law?](#) and [The Tribunal Judiciaire of Paris has sole jurisdiction to hear duty of vigilance lawsuits](#) published respectively on our Blog in December 2021 and February 2022

[2]

https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance_en

[3] <https://data.europa.eu/doi/10.2838/472901>

[4] <https://data.europa.eu/doi/10.2838/39830>



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