

SUSTAINABILITY: NEW PROPOSAL FROM THE EUROPEAN COMMISSION FOR A DIRECTIVE ON CORPORATE DUE DILIGENCE

1. Introduction

On 23 February 2022, the European Commission published its [proposal for a Directive on corporate due diligence regarding sustainability and human rights](#) (the “**Proposal**”), which essentially establishes a duty of due diligence for companies to promote sustainable and responsible business practices across global supply chains.

In this regard, although several Member States already have national legislation in place on due diligence and some companies have adopted measures on their own initiative (in Spain, Article 49.5 of the Commercial Code, when specifying the content of the statement of non-financial information, already establishes the obligation to report on the inclusion of social, gender equality and environmental issues in the company’s purchasing policy, the consideration of social and environmental responsibility in relations with suppliers and subcontractors and the monitoring and auditing systems), the European Commission considers that the implementation of measures adopted to date in the European Union has been insufficient.

Therefore, it believes that certain due diligence obligations regarding actual or potential adverse effects on human rights and the environment should be placed on companies of a certain size in relation to their operations, subsidiaries, supply chains and other business relationships. These are reflected in the Proposal, and, in turn, are based on the UN [Guiding Principles on Business and Human Rights](#), the [OECD Guidelines for Multinational Enterprises](#) and the importance of responsible business conduct.

The main aspects of the Proposal are analysed below.

2. Scope of application

The new due diligence rules will apply to the following companies and sectors:

- (i) Companies with more than 500 employees and a worldwide turnover of more than EUR 150 million, as well as certain companies that do not reach this threshold, but have more than 250 employees and a turnover of more than EUR 40 million

provided that at least 50% of their turnover is generated in certain sectors provided for in Article 2.1(b) of the Proposal (textiles, footwear, food, mining, etc.); and

- (ii) Companies not domiciled in an EU country but that generate more than EUR 150 million of turnover in the EU, or between EUR 40 million and EUR 150 million, provided that at least 50% comes from the economic sectors mentioned above.

Small and medium-sized enterprises (SMEs) will not fall directly within the scope of the Proposal. However, they will be indirectly affected by the new rules due to the actions of large companies in their value chains.

3. Obligations

Companies covered by the future Directive will have to identify and, where necessary, prevent, address or mitigate adverse effects on the rights and prohibitions contained in international human rights agreements (e.g. on workers' access to adequate food, clothing, water and sanitation in the workplace) and on the environment, by implementing a series of actions and measures detailed in Articles 5 to 11 of the Directive, including, in particular, the following:

- (i) Approval of a due diligence plan to be updated annually, which should contain:
 - a description of the company's approach, including long-term due diligence;
 - a code of conduct describing the rules and principles to be followed by employees of the company and its subsidiaries; and
 - a description of the due diligence processes implemented (including measures taken to verify compliance with the code of conduct and to extend its application to their business relationships).
- (ii) Adoption of the necessary measures to identify potential or actual adverse effects on human rights and the environment. In the case of financial institutions, this due diligence should only be carried out before granting loans or providing financial services.
- (iii) Adoption of measures to prevent or, if not possible, adequately mitigate adverse effects on human rights and the environment. In particular, they may adopt preventive action plans, establish contractual safeguards in business relations, make the necessary investments to implement preventive systems or provide support to small and medium-sized enterprises with which they have stable

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business relations in order to ensure that compliance with the obligations of the Directive does not jeopardise their viability.

In the event that the adverse effects cannot be prevented or mitigated by applying the above measures, the company should refrain from entering into or extending a contractual relationship (including the supply chain) and, if the law governing the contract so permits, take certain steps (such as suspending the contractual relationship for as long as necessary to prevent or minimise the adverse effects provided that there is a prospect of being able to do so in the short term or terminating the contract). To this end, EU states must adopt legislative measures to enable contracts to be terminated in such cases.

In the case of financial institutions, they shall not be obliged to cancel loans or the provision of financial services where this could reasonably be expected to cause substantial damage to the entity providing or receiving the service.

- (iv) Measures taken to eliminate adverse effects that have been identified and, if not possible, to minimise them. To do so, they should identify the payment of compensation to individuals or communities, implement corrective measures with specific deadlines, introduce contractual commitments in the value chain, make investments and provide support to small and medium-sized enterprises along the lines outlined above. The same provisions for the refusal to enter, non-extension, suspension and termination of contracts as in the previous point and the same exception for financial institutions are also envisaged.
- (v) Implementation of complaint channels for stakeholders (people affected or who can reasonably be expected to be affected, trade unions, value chain workers, civil organisations active in areas related to the value chain).
- (vi) Regular monitoring of measures taken by the company itself, its subsidiaries and their supply chains and business relationships. This assessment shall be based, where appropriate, on qualitative and quantitative metrics and shall be carried out at least every 12 months, and whenever there are reasonable grounds to consider that there may be new risks leading to such adverse effects. The due diligence policy shall be updated in accordance with the outcome of these assessments.
- (vii) Public communication on due diligence. The companies concerned must publish on their website by 30 April each year an annual statement on the matters covered by the Proposal regarding the previous year.
- (viii) In fulfilling their duty to act in the best interests of the company, the directors of the company should take into account the short, medium and long-term consequences

of their decisions on sustainability issues. In addition, they will be responsible for the implementation of due diligence processes and should take measures to adapt the corporate strategy to take into account actual or potential adverse consequences that have been identified, and relevant prevention, cessation and complaint measures. Where company managers receive variable remuneration, they will be incentivised to contribute to the fight against climate change as part of the business plan.

- (ix) In addition, Article 15 of the Directive states that companies incorporated in the European Union with more than 500 employees and a worldwide turnover of more than EUR 150 million, as well as those from third states with a turnover of more than EUR 150 million in the European Union, must adopt a plan to ensure that their business model and strategy are compatible with the transition to a sustainable economy, and with limiting global warming to 1.5 degrees Celsius in line with the Paris Agreement. In this regard, the plan should identify the extent to which climate change is a risk or already has an impact on the company's operations.
- (x) Also, in circumstances where climate change has been or should have been identified as a major risk or a major impact on the company's operations, the company shall include emission reduction in its plan.
- (xi) The Proposal also includes accompanying measures that will support all businesses, including SMEs, that may be indirectly affected. Measures include the creation of specific websites, platforms or portals, individually or jointly, and possible financial support to SMEs.

4. Responsibility, monitoring and control measures

Article 22 of the Proposal provides that companies shall be liable for damage if they fail to comply with the obligations to prevent and eliminate adverse effects, and damage is caused as a result. In this way, victims will have the opportunity to take legal action for damage that could have been avoided with appropriate due diligence measures. In this regard, if the company has introduced the contractual provisions referred to in the Proposal in its clauses with its suppliers, it will not be liable for the damage caused by another party in its value chain, unless it would not be reasonable in the circumstances to expect that the action taken by the company would be adequate to prevent, mitigate, stop or minimise the adverse effect in question.

Member States will designate a national administrative authority, which will be responsible for monitoring the rules introduced by the Directive and may impose fines in the event of non-compliance. In addition, the Directive also requires Member States to adapt their civil liability

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rules to cover cases where the damage arises from a company's failure to comply with due diligence obligations, on the basis of their existing civil liability regimes.

At the European level, the European Commission will set up a European network of supervisory authorities, bringing together representatives of national bodies, to ensure a coordinated approach and facilitate the exchange of knowledge and experience.

5. Next steps and national regulations

The proposal will be submitted to the European Parliament and the Council for adoption. Once the European legislative process has been completed, Member States will have two years to transpose the Directive into national law and communicate the relevant instruments to the Commission. Companies with more than 500 employees and more than EUR 150 million turnover will have two years from the adoption of the Directive to comply with it, and companies with more than 250 employees and turnover of EUR 40 million will have four years.

Furthermore, it is noteworthy that on 14 February the Ministry of Social Rights and Agenda 2030 published a preliminary public consultation on a draft bill on the protection of human rights, sustainability and due diligence in transnational business activities. If the parliamentary processing of this draft bill is carried out quickly, it could precede the approval of the Directive, so it will be necessary to keep an eye on the processing of these two initiatives, both national and European.

This Note was prepared by José María de Paz, Partner of the Corporate/M&A practice and Marisa Delgado, Senior Professional Support Lawyer.

The information contained in this Briefing is of a general nature and does not constitute legal advice. This document was prepared on 3 March 2022 and Pérez-Llorca does not assume any commitment to update or revise its contents.

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