FESE Position Paper on the Proposal for a Directive on Corporate Sustainability Due Diligence

Brussels, 4th October 2022

Introductory remarks

FESE fully supports the European Union (EU) Green Deal, the EU Sustainable Finance agenda and the global transfer of assets towards a more sustainable economy. We believe that the proposal from the European Commission (EC) for a Directive on Corporate Sustainability Due Diligence (CSDDD) will contribute to the EU's efforts and commitment to ease the path to the transition to a carbon-neutral and inclusive economy.

We welcome the EC's objectives to address adverse human rights and environmental impacts. An EU framework dedicated to mitigating and preventing such scenarios will – hopefully – allow for accountability in sustainable and responsible corporate behaviour and create a level playing field for companies in the single market, whilst avoiding fragmentation and reducing legal uncertainty, especially for large companies operating across borders.

FESE believes that these objectives are feasible, subject to the new requirements being proportionate to the size of the reporting companies (and their affiliation to the parent company), to SMEs being exempted from such due diligence requirements and to the proposals respecting existing international frameworks. In addition, the envisaged guidance by the EC should take into account sector-specificities, a widely used and effective approach when it comes to corporate sustainability management.

Furthermore, we believe that coherence with international standards must be ensured to create a truly global level playing field and provide legal clarity for companies with international value and supply chains. The EU should actively cooperate with the OECD to facilitate international harmonisation in this respect. In addition, policymakers should avoid overlapping requirements, as an increasing body of sectoral legislation is being developed.

With this paper, we would like to offer some additional considerations and raise some concerns in respect to the risk of regulatory disruption especially for the parts on governance, the scope of the proposal - more specifically on the lack of harmonisation with other upcoming ESG reporting legislation i.e. the proposed Corporate Sustainability Reporting Directive (CSRD) - and the absence of the possibility of consolidation of due diligence requirements by the parent undertaking.

1. Scope

1.1. A proportional scope

FESE welcomes the fact that the proposed obligations apply exclusively to large undertakings irrespective of the type of funding they have opted for (i.e. whether they are listed or not), as the benefits of due diligence duties are not only linked to listed companies, but to all companies. Such policies would otherwise discourage potential issuers from going public, which would be detrimental to capital markets and the further development of the EU Single Market.

Also, we agree with the EC that SMEs should be excluded from the due diligence duty as the financial and administrative burden of setting up and implementing a due diligence process would be relatively high.

Nonetheless, in line with the proportionality principle, FESE strongly believes that due diligence duties should be developed in a way that allows as many large undertakings as possible to comply, even if they may be very different in terms of type of business, business model, organisation, etc. This is reflected in the "personal scope" of the due diligence obligations between Group 1 and Group 2.

Lastly, FESE supports the inclusion of third-country companies in the scope to promote a level playing field but also to effectively deliver the CSDDD's objective of addressing human rights and adverse environmental impacts in companies' operations and value chains. At the same time, it needs to be ensured that rules for third-country companies are proportionate. Otherwise, the extra-territorial effect of the Directive may be prejudicial to EU markets, if those third-country companies will avoid the EU and choose to work with non-EU competitors instead. It may also risk introducing unintended consequences that may deter companies from investing in the EU, and the consequent impact on the CMU and the EU's global competitiveness, such as those that can already be foreseen in relation to the CSRD proposal. Also, due consideration must be given in terms of the enforcement and supervision of third-country companies.

Against this background, adjusting the EC proposal is of utmost importance. We believe that, currently, the proposals are not clear as to whether companies' due diligence obligation concerns all operations of the non-EU entity worldwide or only those linked to the products or services offered in the EU.

Consequently, the former interpretation could indicate that the CSDDD would cover business activities that do not have any connection with the EU, such as the provision of financial services from a third-country financial company to a third-country non-financial company with activities exclusively outside the EU, which often represent the majority of the business activities of third-country companies. Requiring third-country companies operating globally to comply with the CSDDD requirements throughout the entire group represents a disproportionate burden for third-country companies active in the EU. This might force them to withdraw from the EU market with potentially detrimental effects on the wider EU economy.

For the reasons explained above, we propose that clarifications be made so that the due diligence obligations be limited to entities' supply chain of the products offered in the EU.

1.2. Harmonisation across legislation

With a growing body of legislation in the field of sustainable finance, FESE wishes to underline the importance of harmonisation between the different pieces of legislation. This would allow legal frameworks and best practices to align better and avoid overlapping regulatory obligations.

1.3. Absence of due diligence consolidation at the level of the parent undertaking

FESE questions the absence of a provision which would allow for "parent undertakings" to consolidate their companies' new due diligence requirements in Article 4. We believe that parent undertakings should have the choice to consolidate the actions to conduct human rights and environmental due diligence on behalf of and accountable to the companies within its group.

With the absence of such a provision, we believe that the new requirements would create duplication of due diligence reporting across companies of the same groups which would prove burdensome and costly.

1.4. Due diligence focused on ‘supply chains’

FESE considers that the concept of ‘value chain’, as defined in Article 3(g), would introduce confusion as to the scope of responsibility. FESE would be in favour of aligning the scope more closely with the concept of ‘supply chain’. Indeed, several of the international texts referred to in the CSDDD also refer to ‘supply chains’, such as the OECD Guidelines for Multinational Enterprises.

2. Due diligence obligations

The implementation of the due diligence obligations as foreseen in the proposal could be very challenging. Monitoring the entire value/supply chain, both upstream as well as downstream, would be very complex, considering the sheer number of suppliers for many companies. This is further complicated by the fact that, in some instances, there are often only a few suppliers available for highly specialized products and, therefore, placing an order with an alternative supplier is therefore not always an option. Moreover, effectively mitigating each and every single risk that may occur in supply chains would be an almost impossible task for companies.

Further, the due diligence duties apparently apply without restriction to indirect suppliers, which can lead to excessive demands on responsibility at the indirect levels in the supply chain. A possible solution could be to differentiate between due diligence requirements in a company’s own operations and its direct suppliers on the one hand and indirect suppliers on the other hand.

3. Duty of care

The CSDDD seeks to clarify that directors should take sustainability matters into account when acting in the best interests of the company. While we fully support that environmental factors and human rights are increasingly recognised in corporate governance, we would caution against overly prescriptive provisions since the political and economic environment is evolving constantly. Holding businesses responsible is important, but the task of protecting human rights and the environment cannot be shifted entirely onto them. There should be a clear distinction between, on the one hand, corporate governance obligations of companies and human rights and on the other, environmental policies pursued by government agencies.

Further to these aspects, the CSDDD should also specify whether it applies to executive or non-executive directors. FESE believes that it would be counter-intuitive to hold non-executive directors accountable for setting and enforcing measurable targets within a company, which is the responsibility of the company’s executives. We note that national company law frameworks as well as corporate governance codes already include much of what is included in the EC’s proposal. This concerns especially Articles 15.3 (remuneration), 25 (directors’ duties) and 26 (due diligence implementation). Already today, the company boards are required to take account of consequences for the company and external stakeholders in all areas relevant to the company in their decision-making. Similarly, directors would already need to ensure that the company complies with its regulatory obligations, including on due diligence. A more appropriate alternative would be to address these requirements to the company instead of individual directors. Interfering with the principles of management of companies also risks negatively impacting the shareholders’ right of ownership.

Lastly, we believe that the provisions on directors’ remuneration are better placed in national legislation, where considerations can be made as to how such governance rules fit into the broader context of national company law. We also note that the Shareholders Rights Directive already foresees long-term interests as ESG criteria as regards directors’ remuneration. Article 15.3 of CSDDD should therefore be considered for removal.

4. Standards

The obligations set out in the CSDDD incorporate international environmental and human rights conventions. These conventions are generally directed at States as parties and the obligations are formulated in broad, vague terms. As such, these provisions are not suitable to serve as clear, statutory obligations directed at companies. Moreover, leaving the concretisation of these obligations to Level 2 acts or transpositions in national law is likely to result in divergence across Member States.

Furthermore, the CSDDD could be further aligned with global due diligence standards. In this regard, FESE would urge the EU to coordinate and align its due diligence framework with other jurisdictions to make sure that EU and third-country companies under the scope do not get caught by overlapping and/or conflicting requirements set out by different jurisdictions. A globally coordinated approach would ensure a level playing field across companies and jurisdictions. In this context, we also encourage the EU to strengthen cooperation at the international level to improve and update where necessary current international regimes and industry schemes, like the UN Guiding Principles on Business and Human Rights (UNGP), the OECD Guidelines for Multinational Enterprises, and the Responsible Business Alliance (RBA), with the ultimate goal of developing a global framework governed by international standards.

5. Transition plans

The EC's proposal introduces the duty to establish a transition plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the Paris Agreement (Article 15). However, FESE is concerned that there would be confusion on the requirement regarding the elaboration of these documents as similar 'transition' plans are also referred to and included in both the CSDR and EU Green Bond standard. Therefore, further insights would be welcome regarding how this proposal would interact with legislative dossiers under development, where its inclusion is also under discussion.

Furthermore, according to Article 15, the transition plans shall identify "the extent to which climate change is a risk for, or an impact of, the company's operations". This requirement is very vague and could lead to confusion.

6. Supervision & Enforcement

Regarding supervision and enforcement, FESE welcomes the fact that supervisory compliance powers will be designated to "one or more supervisory authorities". It is important to emphasise that such National Supervisory Authorities designated by Member States should coordinate with the relevant supervisory authorities of the companies in scope to ensure consistency (for example, National Competent Authorities in charge of the supervision of listed companies' compliance to the CSDDD).

In particular, FESE welcomes the creation of the European Network of Supervisory Authorities. We believe that this EU-level structure will be key to ensuring the consistent implementation and enforcement of national provisions and facilitating effective cooperation and coordination between National Supervisory Authorities.

Regarding enforcement mechanisms, we believe that there are improvements to be made. While the CSDDD emphasises administrative actions and civil liability, it should also include more non-judicial grievance mechanisms and extra-judicial remedies. Including these elements would acknowledge the dynamic, interactive and consultative nature of due

diligence in the context of sustainability and the importance of information sharing, learning and responsiveness between companies and stakeholders.

7. Sector-specific guidance

Accompanying measures would be very helpful in helping companies to navigate and adjust to the new requirements. In particular, FESE believes that it would be highly beneficial for the EC to develop clear guidance that takes into account sector specificities, also for the financial sector. This is a widely used and effective approach when it comes to corporate sustainability management.

8. Civil liability

The proposal explicitly provides for civil liability if companies fail to comply with the due diligence obligations to prevent potential adverse impacts or to bring actual adverse impacts to an end. In this context, liability is not limited to own breaches but is also conceivable for breaches by subsidiaries as well as suppliers over which companies do not necessarily have sufficient control.

Due to its broad scope, FESE believes that Article 22 would lead to disproportionate litigation risks for companies. Further, the civil liability regime also contradicts the 'best efforts' approach of the proposal. If no success, but rather best effort is owed, companies should not be under threat of potential lawsuits being launched against them.

As a consequence, FESE would favour the deletion of Article 22. In our opinion, the proposed sanctions regime (Article 20) is sufficient to ensure compliance.