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The Emergence of a European Duty of Vigilance for Large Companies and Its Potential Impact at the National Level

On 23 February 2022, the European Commission adopted its much-anticipated proposal on corporate sustainability due diligence. By setting a standard, the future directive will not only help improve corporate sustainability, but also avoid fragmentation of the single market in 27 Member State legislations, as some countries in Europe have already adopted their own regulation.

What Is the Purpose of the Directive?

The proposal for a Directive on Corporate Sustainability Due Diligence (the Proposed Directive) is the first of its kind to impose general corporate social responsibility legislation at the European level. Indeed, the College of the European Commission has described the proposal as a "real game-changer in the way companies operate their business activities throughout their global supply chain".

The European Commission determined that voluntary actions taken by companies have failed to generate a sufficiently positive and large-scale impact. As such, it proposes to impose a due diligence obligation on companies.

With the Proposed Directive, the European Commission intends to:

- Improve corporate governance practices to better integrate risk management and mitigation processes of human rights and environmental risks and impacts into corporate strategies, including those stemming from value chains
- Avoid fragmentation of due diligence requirements in the single market and create legal certainty for businesses and stakeholders as regards expected behavior and liability
- Increase corporate accountability for adverse impacts, and ensure coherence for companies regarding obligations under existing and proposed EU initiatives on responsible business conduct
- Expand access to remedies for those affected by adverse human rights and environmental impacts of corporate behavior
- Complement other measures in force or proposed, which directly address specific sustainability challenges or apply in specific sectors, mostly within the Union

What Obligations Will the Directive Impose?

The Proposed Directive will establish a corporate due diligence duty and will apply to a company's own operations, its subsidiaries, and its value chains (direct and indirect established business relationships).

In order to comply with the corporate due diligence duty, companies should:

- Integrate due diligence into their policies (that they should update annually), including:
  - A description of the company's approach, including in the long term, to due diligence
  - A code of conduct describing rules and principles for the company's employees and subsidiaries
  - A description of the processes put in place to implement due diligence, including the measures taken to verify compliance with the code of conduct and to extend its application to established business relationships (Article 5)
- Identify actual or potential adverse human rights and environmental impacts in the company's own operations, its subsidiaries, and in the value chain, based on quantitative and qualitative information (Article 6)
- Prevent or mitigate potential impacts of the company's own operations and subsidiaries; the Proposed Directive describes measures such as developing a prevention action plan with reasonable timelines
  - If the company cannot prevent or mitigate potential impacts, it should refrain from entering into new or extending existing relations with the partner in connection to or in the value chain of which the impact has arisen and shall either, when possible, temporarily suspend commercial relationships, or terminate the business relationship related to the concerned activity (Article 7)
- Eliminate or minimize actual impacts by refraining from entering into relations with the concerned partner and, when possible, temporarily suspend commercial relationships or terminate the business relationship related to the concerned activity (Article 8)
- Establish and maintain a complaints procedure in case of legitimate concerns regarding those potential or actual adverse impacts, including in the company's value chain, which is available to:
  - Affected persons or those who have reasonable grounds to believe that they might be affected by an adverse impact
  - Trade unions and other workers' representatives representing individuals working in the value chain concerned
  - Civil society organizations active in the areas related to the value chain concerned (Article 9)
- Monitor the effectiveness of the due diligence policy and measures through at least an annual assessment and whenever there are reasonable grounds to believe that significant new impacts may arise (Article 10)

- Communicate publicly via the company's website by 30 April each year on due diligence measures taken during the previous calendar year; this obligation is limited to companies that are not subject to reporting requirements under Articles 19a and 29a of Directive 2013/34/EU (Article 11)

The Proposed Directive also introduces duties for the directors of the EU companies that fall within scope. These duties include creating and overseeing the implementation of the due diligence processes and integrating due diligence into the corporate strategy. In addition, when fulfilling their duty to act in the best interest of the company, directors should take into account the consequences of their decisions for sustainability matters, including, when applicable, short-, medium-, and long-term human rights, climate change, and environmental consequences.

Which Companies Will Be Affected?

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

- EU companies:
  - Group 1 (involving around 9,400 companies): all EU limited liability companies of substantial size and economic power (with 500+ employees and €150 million plus in net turnover worldwide)
  - Group 2 (involving around 3,400 companies): other limited liability companies operating in defined high-impact sectors, which do not meet both Group 1 thresholds but have more than 250 employees and a net turnover of €40 million plus worldwide; for these companies, rules will start to apply two years later than for Group 1
- Non-EU companies active in the EU with turnover generated in the EU aligned with Group 1 and 2 revenues' thresholds (involving about 2,600 companies in Group 1 and 1,400 companies in Group 2)

Small and medium enterprises (SMEs) are not directly in the scope of this proposal, although the proposal provides for supporting measures for SMEs.

What Will Be the Impact at National Level?

As the Proposed Directive does not seek to replace existing mechanisms already available at the national level, EU Member States with a national regulation will need to determine whether their existing regime needs to be adapted or whether it already complies with the model provided at the European level. So far, France (*Loi relative au devoir de vigilance*, 2017) and Germany (*Sorgfaltspflichtengesetz,* 2021) have introduced a horizontal due diligence law, other Member States (Belgium, the Netherlands, Luxembourg, and Sweden) are planning to do so shortly, and the Netherlands has introduced a more targeted law on child labor (*Wet zorgplicht kinderarbeidm*, 2019). Although some countries such as France have been held up as a model to encourage at the EU level, the Proposed Directive presents an opportunity to reshape or refine the national regimes, especially as the current ones, such as in France or Germany, are not fully in line with the regime set out in the Proposed Directive, and others, such as the 231 Model proposed in Italy, remain voluntary.

Whether national legislators will decide to reform and adapt existing regimes or adopt new regimes based on the European model remains unclear.

France

In France, Law No. 2017-399 of 27 March 2017 (the French Duty of Vigilance Law) established obligations for companies to identify and prevent human rights violation and environmental impacts

resulting from their own activities, from activities of companies they control, as well as from activities of their subcontractors and suppliers with whom they have an established commercial relationship.

Article L. 225-102-4 of the French Commercial Code imposes a duty to elaborate and effectively implement a vigilance plan fallings upon any *société anonyme* (SA) and any *société par actions simplifiée* (SAS) that either:

- Employs, at the end of two consecutive financial years, at least 5,000 employees within the company and in its direct or indirect subsidiaries whose registered office is located on French territory; or

- Employs, at the end of two consecutive financial years, at least 10,000 employees within the company and in its direct or indirect subsidiaries whose registered office is located on French territory or abroad.

Vigilance plans are expected to cover the parent company, the (directly or indirectly) controlled companies, and the activities of subcontractors or suppliers with whom an established business relationship is maintained, when these activities relate to the established relationship. A company's vigilance plan, which should be developed in consultation with relevant stakeholders, is expected to include the following components:

- Risk mapping that identifies, analyzes, and ranks risks

- Procedures to regularly assess, in accordance with the risk mapping, the situation of subsidiaries, subcontractors, or suppliers with whom the company maintains an established commercial relationship

- Appropriate actions to mitigate risks or prevent serious violations

- A hotline for alerts relating to the existence or realization of risks, established in consultation with the trade union representatives in the company

- A monitoring scheme to follow up on the measures implemented and to assess their efficiency

As regards to sanctions, Article L. 225-102-4-II of the French Commercial Code states that a company's failure to comply with the above-mentioned obligations within a three-month period after receiving a formal notice, and following the request of any person with legitimate interest to do so, may result in the relevant jurisdiction issuing an order for the company to comply with its duties, if necessary under penalty, or face financial sanction. Furthermore, Article L. 225-102-5 of the French Commercial Code provides that the company responsible for any failure to comply with these new duties shall be liable and obliged to compensate for the harm that due diligence would have helped to avoid.

Finally, French Law No. 2021-1104 on combating climate change and strengthening resilience to its effects (Climate and Resilience Law) recently introduced additional sanctions for companies that do not comply with their vigilance duties.[1] Under Article 35 of the law, purchasers and licensing authorities will now be able to exclude from the public procurement process the subject companies that did not comply with the obligation to implement a vigilance plan the year preceding the year in which the notice of a competitive tender is published or the consultation is initiated. That said, such exclusion is subject to two conditions: (i) it shall not result in a restriction of competition, and (ii) it shall not make it technically or economically difficult to perform the service at issue.

By comparison, the Draft Directive introduces meaningful changes to the French model, including:

- *Significantly broader scope*, especially with respect to the significantly lower thresholds applicable to number of employees and the extension of its scope to companies with headquarters outside Europe, but with activity in Europe

- *The designation of a national supervisory authority*, which currently does not exist in France, that would be in charge of supervising the new rules set down in the Proposed Directive and as well as imposing fines in case of non-compliance; in France, the Paris Civil Court has now exclusive jurisdiction for matters involving the duty of vigilance

- *Sanctions*, Article 20 of the Proposed Directive establishing, for example, the principle of financial penalties calculated on the basis of a percentage of turnover

Germany

In Germany, the Corporate Due Diligence in Supply Chains Act (*Gesetz über die unternehmerischen Sorgfaltspflichten in Lieferketten*) was published in the Federal Law Gazette (*Bundesgesetzblatt*) on 22 July 2021. The new law imposes mandatory human rights and environmental due diligence obligations, and will apply from 1 January 2023 to German and foreign companies with more than 3,000 employees in Germany. This threshold will be lowered to 1,000 employees in January 2024. The number of employees will generally be calculated on the basis of employees working in Germany and includes employees sent abroad. With regard to the calculation of employees within affiliated companies, the parent company's business also includes the number of employees of affiliated companies if the parent company exercises controlling influence over those companies.

The law aims to strengthen global human and environmental rights by ensuring responsibility within supply chains for companies based in Germany. Led by the UN Guiding Principles on Business and Human Rights, the German government concluded that requiring companies to voluntarily commit to these rights is insufficient if they are to adequately fulfil their human rights and environmental due diligence obligations in their supply chains. The law introduces certain obligations around supply chain due diligence to address this insufficiency, which German authorities have the power to enforce.

In principle, these obligations extend to a company's entire supply chain, but they vary in terms of scrutiny depending on the level of influence on the company's supplier. The first priority is the implementation of due diligence obligations in the company's own business and towards its direct suppliers. Indirect suppliers must also be included in the due diligence on a case-by-case basis as soon as the company has substantial knowledge of human rights or environmental law violations or related risks. The obligations include (i) conducting a human rights risk analysis; (ii) taking preventive and, when appropriate, remedial action; (iii) establishing complaint mechanisms; and (iv) maintaining a comprehensive reporting obligation towards the general public.

The German Federal Office for Economic Affairs and Export Control (*Bundesamt für Wirtschaft und Ausfuhrkontrolle* – BAFA) will be responsible for monitoring and enforcing compliance with due diligence obligations. The BAFA can start the proceedings ex officio on the basis of its own investigations or following an external complaint backed up by substantial evidence, and can instigate significant administrative fines for violation of the due diligence obligations. For companies with annual group turnover of more than €400 million, the fines may be as high as 2% of the average annual global turnover. Companies with an annual turnover of less than €400 million still face fines of up to €800,000, depending on the type of violation. In addition, a violation of the due diligence obligations can lead to an exclusion from participation in public tenders for up to three years.

The Corporate Due Diligence in Supply Chains Act does not provide for a direct civil liability of companies in Germany. Rather, the law contains a clarification according to which a breach of the obligations under the law shall not give rise to civil liability. This provision was added during the legislative procedure after German companies raised concerns at the prospect of potential civil liability for suspected human rights and environmental law violations committed abroad in their supply chains. With ESG litigation on the rise across Europe and in Germany, how German courts will interpret this provision remains to be seen.

Italy

In Italy, there is no specific corporate sustainability due diligence duty (other than the non-financial reporting duties deriving from Articles 19a and 29a of Directive 2013/34/EU). However, pursuant to Italian Legislative Decree no. 231/2001 (the 231 Decree), legal entities can incur a criminal/administrative liability for criminal offences committed at an individual level by directors, executives, their subordinates, and persons acting on behalf of the entity, provided that the conduct was carried out in the interests of, or for the benefit of, the entity.

This criminal/administrative liability relates specifically to identified offences (*reati presupposto* - including, among others, slavery, human trafficking, forced labour, and some of the most serious environmental crimes) and can lead to monetary sanctions (e.g., disqualifications, prohibitions, confiscation of the price or profits of the crime, publication of the judgment) depending on the offence committed.

In order to avoid or mitigate this liability, a legal entity should, among other actions:

- Adopt and implement, before the commission of the crime, an Organization, Management & Control Model (a 231 Model), which is adequate to prevent the commission of the crimes set forth by the 231 Decree. The 231 Model should be constantly updated to reflect changes in the applicable law and complemented by specific procedures aimed at implementing the principles and guidelines set out in the 231 Model, as well as by a whistleblowing procedure and a disciplinary system setting forth internal sanctions for violations of such procedures.

- Appoint an independent 231 Supervisory Body (*Organismo di Vigilanza*) to supervise the functioning of the legal entity, its adherence to the 231 Model procedures, and the commitment to update those procedures.

Even though such regulation, as opposed to the one set forth by the Proposed Directive, applies to all legal entities — with a limited set of particularized exceptions (e.g., constitutionally mandated public entities) — regardless of their corporate structure, dimensions, or business sector, the implementation of a 231 Model is by no means mandatory under Italian law.

What's Next?

At the EU level, the Proposed Directive still needs to be presented to the European Parliament and the Council for approval.

Once adopted, the Member States will have two years to transpose the directive into national law and communicate the relevant national texts to the Commission. In the meantime, the Proposed Directive provides a helpful guide for companies to continue developing due diligence procedures to identify, assess, and mitigate adverse human rights and environmental impacts.

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Endnotes

[1] These new provisions will come into force on dates to be determined by decree and no later than five years after the promulgation of the law (i.e., no later than 22 August 2026). The exclusions at stake will only be applicable to public procurement contracts and concessions for which a consultation is initiated or a competitive tender is sent for publication as from the date of entry into force of the provisions.