AK EUROPA

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Directive on Corporate Sustainability Due Diligence

Executive summary

AK **welcomes** the proposed Directive on Corporate Sustainability Due Diligence. However, the text in its current form contains **numerous weaknesses** and **loopholes** that **threaten to undermine effective regulation**. In order to actually meet the self-imposed goal of better protecting human rights and the environment in transnational corporate activities, the present draft must therefore be **fundamentally improved**.

- The **scope of the Directive is too narrow** and **covers only few large companies**. All companies must be covered **proportionately and appropriately**.
- The due diligence process does **not** consistently cover the **entire value chain** as it is limited to **"established" business relationships**. This **restriction** should be **removed**.
- The list of **human and environmental rights to** be respected is **incomplete**.
- The **due diligence process** sets out corporate approaches, such as formal contractual clauses and audits, that have proven ineffective and inadequate in the past. A **participatory and cooperative approach** is needed, as well as a general regulation providing for **minimum standards and clear liability rules in the audit and certification industry**.
- The planned inclusion of trade unions and employee representatives is completely inadequate. There needs to be a **mandatory strong involvement in the due diligence process**.
- **Climate-related due diligence requirements** are **not** currently **part of the draft**. The urgency of the climate crisis requires the **integration of negative climate impacts into the due diligence process**.
- The draft should **provide for minimum penalties** in the case of sanctions and must ensure that violations include **exclusion from public procurement** and **public funding of any kind**, in particular export subsidies, state aid, guarantees and secured loans.
- The introduction of a liability provision is welcomed. However, **liability** is subject to **narrow limits** and – in the case of controlled companies – **direct liability** should **be considered** irrespective of compliance with due diligence obligations.
- The **access to justice** in transnational proceedings remains **full of obstacles** for victims of human rights violations. The draft must therefore include provisions on **shifting the burden of proof, longer statutes of limitations, class actions and legal aid**.
- The **whistleblower** protections under the draft do not cover important stakeholders such as union employees and human rights and environmental activists. An **adequate protective mechanism** must be provided here.
- The draft provides for a number of **exemptions** for the particularly **risk-prone financial sector** that need to be **corrected**. The financial sector must be **added** to the list of **high-risk industries**.
- The **provisions concerning the obligations of the Board of Directors are to be welcomed but are far too non-binding**. Stricter and clearer guidelines are needed.

AK's position

The European Commission presented a Proposal for a Directive on 23 February 2022 to establish binding human rights and environmental due diligence requirements for companies along their supply chains. The Chamber of Labour and trade unions have been demanding for years that companies be required to respect human rights and environmental standards along their supply chains. It is thanks to the persistent commitment of all stakeholders involved that the proposal, whose publication was delayed several times and almost prevented by intervention of the Regulatory Scrutiny Board, has now been presented after all.

AK expressly welcomes the proposed Directive on Corporate Sustainability Due Diligence. On the positive side, the Proposal includes two forms of law enforcement. First, authorities are to be able to check compliance with due diligence obligations and impose fines in the event of violations. Second, injured parties are to have the possibility to file a lawsuit in court if damage has occurred that would have been avoided if the duties of care had been complied with. The Directive has the potential to ensure decent working conditions and better protection of the environment in our global supply chains. However, in our view, the following improvements are still urgently needed.

Personal scope (Article 2 in conjunction with Article 3a)

On the positive side, it should be emphasised that the Directive is to apply to EU companies, as well as to companies from third countries operating in the EU. On the other hand, it is extremely disappointing that the present draft **only covers selected large companies**. Accordingly, the Directive will only apply to companies with more than 500 employees and net worldwide turnover of more than EUR 150 million. In three high-risk areas (textiles, agriculture, raw materials), the legislation will also extend to companies with more than 250 employees and net worldwide turnover of more than EUR 40 million. In addition to the **complete exclusion of SMEs, many large companies are also excluded from the scope of application** due to the **pairing of the criteria of number of employees and net turnover**. In Austria, this means that the legislation will only apply to around 0.06% of companies. Under the definition in Article 3a, "company" is only taken to mean corporations and certain financial service providers such as credit institutions and insurance companies.

This approach **runs counter to the international standards** to which the European Commission refers several times in the text. The UN Guiding Principles on Business and Human Rights (Guiding Principle 14) clearly state that **all companies** – regardless of their legal form – must comply with **proportionate and appropriate due diligence obligations**. Company size says nothing about whether corporate activity negatively impacts people and the environment. This therefore undermines a risk-based approach. Degrading the protection of human rights and the environment to a niche programme for few large corporations sends out a **devastating signal for the European Union**, which prides itself on value-based policies and likes to emphasise its pioneering role in the promotion ofhuman rights. However, the narrow scope of application is also unconvincing for other reasons. Accordingly, the goal expressly stated by the European Commission of achieving a **level playing field on the internal market** is **far from met**. Moreover, especially when it comes to complex issues of influencing the entire supply chain and indirect business partners, it is of enormous importance to be able to count on the so-called "Brussels effect", i.e. **increasing leverage** through harmonised regulations. However, this can only be effective if all links in the European supply chains are subject to the same regulations. Conversely, the situation is **not satisfactory for SMEs** either. Many Austrian SMEs are already taking measures to promote sustainability in their supply chains and face **competitive disadvantages** in the market because other suppliers produce far more cheaply by exploiting people and the environment. This **weakens the business location** and does not remedy existing grievances. SMEs operating as suppliers to large companies, on the other hand, will be **indirectly covered by** the Directive and face **legal uncertainty**. The **model contractual clauses** and **contractual cascading** provided for in the Directive **(rightly) place the onus on all suppliers**.

It should therefore be demanded that all companies be covered by the legislation, with exemptions possible for sole traders and micro-enterprises. At minimum the scope of application set out in the Resolution of the European Parliament of 10 March 2021 should be adopted, which covers all large companies as well as SMEs if they operate in high-risk areas. **The high-risk sectors should be expanded to include construction, energy, transportation, auditing/certification and financial services**. State-owned and state-affiliated enterprises should be explicitly mentioned for reasons of legal clarity.

Inclusion of the entire value chain (Article 1 in conjunction with Article 3f)

It is to be welcomed that the draft Directive in principle prescribes a due diligence process that covers the entire value chain (upstream and downstream) – from the development of a product or service to its disposal and related activities. However, there is one **important exemption to** this rule, **which carries the risk of human rights violations and environmental degradation not being included precisely in cases where there is increased risk**: in short-term and low-intensity business relationships. The Directive introduces the concept of "**established business relationship**" in EU law and **limits the due diligence obligations** in the value chain to **these relationships**, which, according to the definition in Article 3f, are of a lasting character in terms of intensity or duration and do not represent a negligible or merely ancillary part of the value chain. The first point to note in this regard is that this definition does not create legal certainty, and it is **unclear which business relationships will not be checked by companies for human and environmental risks as** a result. The approach could even unintentionally create **incentives** to **change suppliers frequently** in order to avoid the obligations under the Directive.

On this point, the draft once again deviates from the urgently needed risk-based approach set out in the international standards. **Companies must be** required to **focus attention** precisely **where the greatest risks of human rights abuses and environmental degradation exist**, not where it is easiest for them. Due diligence revolves around the **criteria of severity and likelihood of imminent injury**. Only in a downstream second step is the question then to be asked as to what specific measures a company can take and how influence can be exerted to remedy the situation. The introduction of "established business relationships" should therefore be removed.

Human rights and the environment – material scope (Article 3 and the Annex)

Companies are required by the draft to exercise due diligence in the areas of human rights and the environment in order to prevent negative impacts. To flesh out this obligation, an **incomplete list of** violations of prohibitions, rights and obligations **under international agreements** is provided in the Annex to the Directive. In the human rights section, a catch-all clause refers to a subsequent list of international conventions and ILO conventions, which again is incomplete. **While it is welcome that the ILO Core Labour Standards and Declarations of Principles have been included, the ILO Occupational Safety and Health Conventions**, which are expected to be added to the set of core labour standards in the foreseeable future, are **missing**. In addition, the **priority conventions of the ILO (81, 129, 144 and 122)**, which deal with **labour inspections, social partner consultations** and **employment policy**, should not be overlooked. When the Rana Plaza textile factory collapsed nine years ago, killing more than 1,100 people, it was precisely the failure to comply with and monitor basic safety regulations in the workplace that was the cause of the disaster. Furthermore, reference is made to the importance of including **ILO Convention 169 on the protection of indigenous and tribal peoples**.

Relevant **European human rights instruments**, some of which provide for higher standards of protection, are **completely missing from the Annex**. The European Convention on Human Rights, the Charter of Fundamental Rights and the European Social Charter are particularly worthy of mention here.

With regard to environmental aspects, it should be noted that there is a need for improvement. It is utterly incomprehensible that the major climate issue has been left out, although there is urgent need for action (for more information, see under Article 15). Furthermore, the list only refers to violations of a **few environmental agreements** but fails to make **environmental damage in general** the subject of due diligence and to anchor **general environmental law principles** such as the precautionary principle and the "polluter pays" principle in the text.

The due diligence process (Articles 4-10)

Articles 4 to 11 set out the **due diligence process** to be undertaken by companies, as well as related obligations. The due diligence process in accordance with Article 4 is based on the requirements of the OECD Guidelines for Multinational Enterprises. **However**, the rules **on** the individual due diligence steps **deviate in some parts flagrantly from international standards**.

In trying to provide companies with simple and easily operable solutions, the EU Commission unfortunately loses sight of the people who should be the focus of the Directive. With codes of conduct, prevention plans, model contractual clauses, contractual assurances and third-party audits, the European Commission relies heavily on **unilateral, formal measures** that risk passing on corporate obligations along the value chain and **reducing** compliance with due diligence obligations to a **mere tick-box exercise. What is needed** is a **strong generally stated commitment to take action to prevent and remedy negative impacts**, as well as a strong **focus on participatory and collaborative elements**, such as exchange, training, communication and long-term collaboration.

The draft merely refers in the recitals to the central role that corporate procurement practices and price specifications have on human rights and the environment along the value chain. When paying prices below production costs or specifying extremely short delivery times, companies directly cause human rights violations due to failure to pay living wages, excessive working hours, piecework, outsourcing to shadow factories or child labour because the contractual conditions cannot be met in any other way. **The central role of purchasing practices, which also reflect companies' business models, must be included in the text.**

Completely inadequate inclusion of trade unions and employee representatives

No one knows the **working conditions, risks and burdens at the workplace** better than the employees and their representatives along the value chain. It is the intrinsic **task of trade unions and employee representatives to** stand up for the concerns and rights of employees on a daily basis. In the international context, they sometimes do so under life-threatening conditions, as the Global Rights Index of the International Trade Union Confederation shows. **In order for international labour standards to be effectively implemented in practice in the world of work, freedom of association and collective bargaining and the social dialogue based on them are needed.** Trade unions and employee representatives can provide information on where rights are violated and risks exist. Furthermore, they can provide information about which risk prevention measures are effective in practice and which are not. Comprehensive mandatory involvement in the due diligence process is thus a basic prerequisite for its effective implementation in practice. **It is therefore all the more incomprehensible that involvement is only provided for on an ad-hoc basis and is not mandatory**. Thus, while the opportunity for unions to become involved in the complaints **procedure** is also welcome, it represents a **purely reactive means of participation.**

AK calls – as did the Parliament's resolution of 10 March 2021 – for the **introduction of a separate article** ensuring the **comprehensive, mandatory involvement of trade unions and employee representatives in the entire due diligence process.**

Reporting – Article 11

The final step of the due diligence process is communication of the results of the aforementioned activities. The Commission's proposal does **not introduce any new reporting requirements for EU companies** because these are already **covered by** the **sustainability reporting** proposal. **By means of a delegated act**, the European Commission is to **regulate** the content and criteria of **reporting** with regard to **companies from third countries**. Such companies are to be required to post an annual statement to this effect on their website – in a lingua franca commonly used in the international business world. Here, it is important to ensure, first, that the reporting obligations **comply with the requirements of the UN Guiding Principles** and, second, that the reporting obligations of European companies and companies from third countries correspond to one another, so that a corresponding **comparability of** the **reports** is ensured. **Documentation requirements are missing from** the draft; these should be for a minimum period of five years so that a review by authorities and other stakeholders is possible.

Commercial activities and the climate crisis – Article 15

The draft requires very large companies to **prepare a climate plan** that must be in line with the requirements under the Paris Agreement to limit global warming to 1.5°C. If climate change is a principal risk or impact of the company's operations, **emission reduction objectives are to be included in the plan**. However, it is not specified when this is to be the case.

The inclusion of climate-related obligations in the Directive is to be welcomed, but unfortunately these are extremely **non-binding** and **unspecific**. AK urges **integration of greenhouse gas emissions into the environment-related negative impacts and expansion of the Annex to include commitments under the Paris Agreement, thereby making them subject to the due diligence process.** In this way, climate lawsuits would be ensured in case damages occur.

State and private enforcement– Articles 17-24

Law enforcement is built on **two pillars**. Member States are required to appoint **supervisory authorities** to **monitor** compliance with the obligations under the Directive. In addition, **civil liability** is intended to ensure that companies are liable for damages that would not have occurred if they had exercised their duty of care.

State enforcement

It is to be **welcomed** that the draft in Article 17(8) establishes important obligations for the **supervisory authorities**, which must act **independently, impartially and transparently**. Appropriate powers ensure that the authorities can also take the necessary investigative steps. Here, the **recommendation** should be made to **carry out official controls according to a risk-based plan** and – in contrast to the current provision – to **carry out** the **verification without prior notice** as a **rule**, as is also provided for in the draft regulation on deforestation-free products (Article 14(12)). The possibility provided for in Article 19 for third parties to raise substantiated concerns is welcomed. To achieve minimum harmonisation, Article 20 should provide for **minimum penalties**. Experience with the EU Timber Trade Regulation shows that the sanctions regime has been **implemented in** an extremely **inconsistent manner**, which in reality leads to forms of **circumvention and practical ineffectiveness**.

In addition to monitoring, appropriate **economic policy flanking measures** should be provided for. Under Article 24, companies must confirm that no sanctions have been imposed on them for non-compliance with the obligations under the Directive when applying for public support. This formulation is too weak. **Exclusion from public procurement** must be set out as a sanction in the case of violations. Corresponding adjustments should be made in the fields of **public procurement** and **subsidy policy**. It must be ensured that the **verifiable fulfilment of due diligence requirements** for the receipt of public contracts, as well as other public funds – in particular research, development and economic subsidies, such as **export subsidies, guarantees** or **government-backed loans** – is mandatory.

Unfortunately, the draft fails to introduce criminal sanctions. It is high time to introduce corporate criminal law at the European level that addresses corporate accountability.

Private enforcement

AK welcomes the **introduction of a civil liability rule**. According to the draft, companies are to be liable if they have failed to comply with obligations under Articles 7 and 8 and, as a result, an adverse impact has occurred that has led to harm and should have been identified, prevented, mitigated, brought to an end or minimised if the due diligence process had been carried out as required. First, it should be noted that liability is only possible if an action is brought against a breach of due diligence to avoid potential adverse impacts or to bring actual adverse impacts to an end (Articles 7 and 8). **Liability should extend to failure to comply with all due diligence obligations**. Furthermore, it should be noted that **an exclusion of liability is not justified in all situations in the case of the mere fulfilment of due diligence obligations** (so-called due diligence defence). This applies, for example, to the occurrence of damage at **subsidiaries** or generally controlled undertakings.

Liability in the case of indirect business partners is subject to **very narrow limits**. A **de-facto safe harbour clause** precludes liability if it can be shown that **contractual assurances** were obtained and **audited**. From the perspective of companies, this approach may seem practicable and understandable. However, it is important to note that the **certification and audit industry is currently not subject to any legal regulations**. There are **no minimum requirements for the quality of audits**, for the training and professional development of auditors, for transparency requirements, for dealing with conflicts of interest, for key indicators to be queried etc. Liability for faulty and low-quality audits is also not regulated. Here it must be clearly demanded that 1.) such **legal minimum requirements be urgently issued** and 2.) **until such requirements are issued there must be no legal cementing of a demonstrably error-prone, ineffective and cost-intensive system such as the auditing industry in the present Directive**.

Finally, it should be noted that the liability rule in question opens up the possibility of claims for damages. However, the possibility of bringing **injunctions** is not provided for. Only such lawsuits would be of use in cases where attempts are made to **prevent the formation and activity of trade unions** or in the event of environmental hazards. It is therefore **strongly recommended that civil liability be extended accordingly**.

In order to ensure a high level of compliance with standards, the **introduction of** a lawsuit under competition law is necessary. It is requested that a procedural possibility be created for competitors to bring a lawsuit in the event of non-compliance with due diligence obligations by other companies under this Directive. This would be conducive to a dynamic of self-regulation and give compliant companies the opportunity to take direct action when competitors gain competitive advantages through violations of fundamental rights.

Lack of effective remedy for those affected

Even with the introduction of a liability option, it is anything but easy for injured parties to enforce claims in proceedings. There are numerous obstacles in transnational proceedings, such as unfair rules on burden of proof, short statutes of limitations, lack of opportunities for collective and class actions and inadequate legal aid. The **draft does not address these obstacles**. In order to comply with a **human rights-based approach**, appropriate provisions should be included. In particular, a provision on the **reversal of the burden of proof** should be included, as also called for by the European Agency for Fundamental Rights. For victims of human rights violations, it is extremely difficult – because the company is in possession of the relevant documents – to prove that a duty of care has been breached and that the victim has suffered damage.

With regard to the **applicable law**, the draft provides for the liability provision to be declared an **overriding** mandatory provision under the Rome II Regulation, thus ensuring its applicability if the applicable law is not the law of the Member State. Here, too, the recommendation of the European Agency for Fundamental Rights should be followed and the Rome II Regulation should be amended to provide for a choice of law for the plaintiff.

Ensure comprehensive protection for whistleblowers – Article 23

The draft extends the protection of the Whistleblower Directive to include reporting of due diligence violations. This **approach is welcome, but remains incomplete**: Trade union employees and human rights and environmental activists are not protected. The **comprehensive protection for all affected stakeholders** has to be ensured, especially in light of the terrible record of 2020: 227 environmental activists were murdered for their activities.

No special treatment for the high-risk financial services sector

The financial sector receives special treatment in the Directive in several respects. Although the financial sector is one of the high-risk sectors according to the OECD Guidelines – which the EU Commission itself claims to have followed – it is **not included** in the **list of high-risk sectors** under Article 2(1)(b). In addition, the absurd link between the number of employees and net turnover means that only very few financial institutions will be covered by the proposed legislation, because they often have a small number of employees but manage considerable amounts of money.

The draft is **peppered with exemptions**: according to Article 3(g), **the value chain** for the financial sector already **ends with the customer** who receives financial services. If this customer is an **SME, due diligence obligations cease to apply altogether**. According to Article 6(3), the due **diligence process is limited to the period before the service is** provided. The special treatment of the high-risk financial sector should be revoked and it should be put on an equal footing with the other high-risk sectors, in line with a risk-based approach.

Board duties – Articles 15(3), 25 and 26

Originally, the European Commission's **initiative in** question went by the title "Sustainable Corporate Governance" and was intended to **deal with board obligations** in the field of sustainability on an **equal footing with corporate due diligence obligations**. The need for this was underpinned in a study by the European Commission, which showed that corporate management is very much oriented towards short-term, financial goals, such as increasing profits and the share price, while long-term sustainability aspects hardly play a role. It is all the more **regrettable** that the present draft – under Articles 15(3), 25 and 26 – contains **only a few provisions in extremely non-binding, vague language.**

Corporate management – when acting in the best interests of the company – must consider the short-term, medium-term and long-term consequences of its decisions on sustainability aspects, "including, where applicable, human rights, climate change and environmental consequences". This double wording **lacks concrete targets** and needs to be specified in more detail. **Mandatory interlinking with the SDGs and the European climate and energy targets** is needed. In addition, it must be **mandatory for management and supervisory bodies to include sustainability expertise**. The establishment of a

Chief Sustainability Officer and a sustainability expert on the supervisory board would be worth considering here.

Fulfilment of the climate-related obligations under Article 15 is to be taken into account when determining variable remuneration, but only "if **variable remuneration** is linked to the contribution of a director to the company's business strategy and long-term interests and sustainability". The **latter condition must be removed in order for the legislation to be of practical relevance.** For the transformation to a sustainable economy to succeed, **sustainability aspects must** become **an integral part of remuneration of the board of directors**. The wording of the draft is therefore highly non-binding in character; what is needed is a **clear commitment to link compensation to sustainability-related performance criteria.** A **minimum weighting of 33% for social and environmental objectives should be set out here.**

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About Us

The Austrian Federal Chamber of Labour (AK) is by law representing the interests of about 3.8 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore, the Austrian Federal Chamber of Labour is a part of the Austrian social partnership. The Austrian Federal Chamber of Labour is registered at the EU Transparency Register under the number 23869471911-54.

The main objectives of the 1991 established AK EUROPA Office in Brussels are the representation of AK vis-à-vis the European Institutions and interest groups, the monitoring of EU policies and to transfer relevant Information from Brussels to Austria, as well as to lobby the in Austria developed expertise and positions of the Austrian Federal Chamber of Labour in Brussels.