

# Directive on Corporate Sustainability Due Diligence

28-29 March 2022

## CORPORATE SUSTAINABILITY DUE DILIGENCE AND THE SHIFTING BALANCE BETWEEN SOFT LAW AND HARD LAW IN THE EU

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# Introduction

- International soft law already concerns adverse impacts on human rights and the environment
- The proposed Directive would translate international soft law into EU hard law by introducing a harmonized regulatory and supervisory framework relative to corporate due diligence



# Obligations

- The new obligations for companies regard the actual and potential environmental adverse impacts and human rights adverse impacts
  - The former derive from the violation of one of the prohibitions and obligations pursuant to the international environmental conventions listed in the Annex, Part II
  - The latter result from the violation of one of the rights or prohibitions listed in the Annex, Part I Section 1, as enshrined in the international conventions listed in the Annex, Part I Section 2



# Obligations

- These definitions raise some concerns given that
  - the international conventions generally foresee obligations of States
  - the international obligations and prohibitions are often defined in general terms
  - as a result, the precise contents of the corporate obligations and prohibitions may be hard to determine



# Obligations

- The case of climate change confirms these concerns. Article 15 provides the following
  - companies shall adopt a plan to ensure that their business model and strategy are compatible with the transition to a sustainable economy
  - they should include emission reduction objectives in their plan;
  - variable remuneration should be set accordingly



# Obligations

- However
  - the targets set by the international conventions as to emission reduction regard all economic sectors and are global in character
  - it is difficult (if not impossible) to derive from them specific requirements for individual companies, business sectors and geographic areas



# Due diligence

- Due diligence is defined by the proposed Directive with reference to the “appropriate measures” which can achieve the objectives of due diligence
  - These measures should be reasonably available to the company,
  - The main obligations of the Directive should be understood as ‘obligations of means’
  - The due diligence process includes risk management systems and compliance programs
  - However, it also extends to bringing adverse impacts to an end
- Therefore, due diligence includes both preventive measures and remedial actions which should however be limited to what is “reasonable” in the circumstances of the case





# From soft law to EU regulation

- The proposed Directive aims to translate soft law recommendations into hard law obligations
  - However, the regulatory provisions should often be more specific and clearly defined ...
  - ... also considering that public sanctions and civil liability would apply to violations of the relevant rights and prohibitions



# From soft law to EU regulation

- The text of the Directive is for now rather imprecise and broadly formulated
  - its ultimate specification would likely occur through national implementation of the relevant rules and/or through secondary legislation which may be adopted at either EU or national level
  - This may determine more rigidity with respect to international soft law and less homogeneity at EU and international levels



# From soft law to EU regulation

- Moreover, the proposed Directive would apply to a vast number of companies that are often much smaller than those to which the soft law instruments presently apply
  - the proposed Directive would cover both companies which are formed in accordance with the legislation of a Member State and companies which are formed in accordance with the legislation of a third country ...
  - ... provided that certain conditions are satisfied (for EU companies: 500 employees and 150 million of turnover)



# From soft law to EU regulation

- The Directive would further reverberate its effects on a greater number of companies
  - the companies to which the Directive would apply are also accountable for monitoring the behaviour of their business relationships in the value chain
  - These include SMEs which work either upstream or downstream in the supply chain



# Relationship with company law

- The proposed Directive (except its provisions on director duties) would mainly belong to the field of public regulation
  - its regulatory aspects would prevail whenever the social cost of negative impacts exceeds their private cost for the company
  - regulation is required precisely to make companies internalize their negative externalities on the environment or society



# Relationship with company law

- The situation is similar for banks and banking regulation is similarly justified by the need for banks to internalize their social costs. The banking analogy should help identifying
  - the main characters of sustainability due diligence regulation
  - its relationship with company law in areas like risk management.



# EU companies v. third country ones

- The cross-border and competitive impacts of the proposed Directive should also be considered
  - Many EU firms would be subject to it and would also be responsible - to some extent - for their subsidiaries and business relationships which may be in different parts of the globe
  - This may put the relevant EU firms at a competitive disadvantage with respect to their non-EU competitors



# EU companies v. third country ones

- At the same time, a good number of third country firms would fall under the national rules implementing the proposed Directive
  - This would reduce the anti-competitive impact of the Directive on EU firms
  - but could also put the EU markets at a disadvantage to the extent that third country firms would shun those markets to circumvent the Directive's requirements.





# Concluding remarks

- The core ideas of the proposed Directive are sound, but its formulation presents shortcomings which require further reflection; in particular:
  - the trade-offs between sustainability and economic performance of the firms covered need further consideration ...
  - ...together with the incentives that lead corporations and their directors to include ESG considerations in their corporate purpose
- Further reflection and analysis could lead to a better balance between corporate governance and the regulation of sustainability due diligence.



Thank you!



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