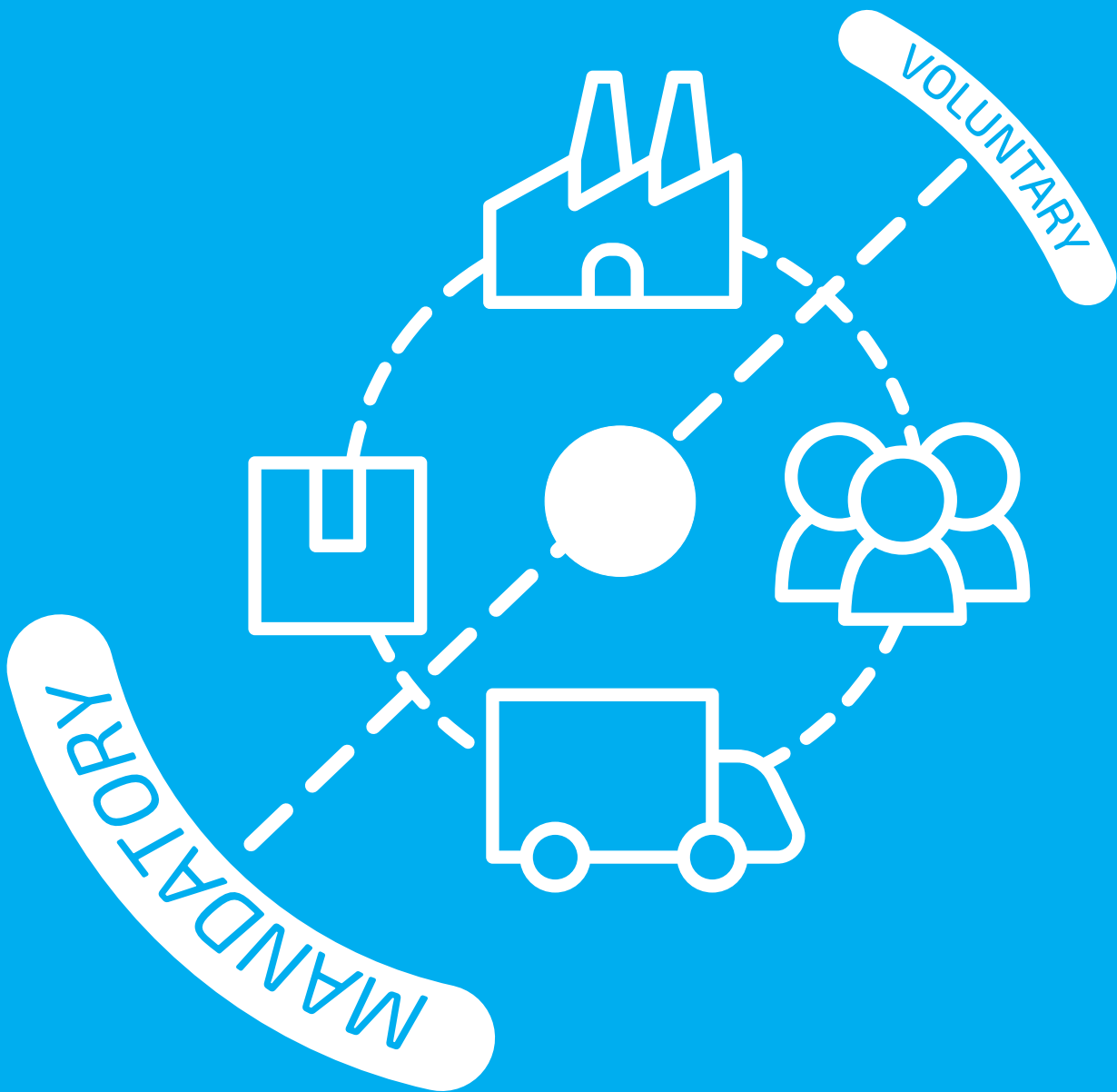


MAKING CORPORATE ACCOUNTABILITY MANDATORY IN THE EU

By Ross Fitzpatrick | March 2022



Evaluating the European Commission's draft Directive on Corporate Sustainability Due Diligence

Context

On 29 April 2020, the European Commissioner for Justice, Didier Reynders, announced the European Commission's commitment to introduce a [Sustainable Corporate Governance](#) initiative to improve the EU regulatory framework on company law and corporate governance. After multiple delays, the Commission's legislative proposal for a Corporate Sustainability Due Diligence Directive was [published](#) on 23 February 2022.

Central to this initiative is the proposal to introduce binding EU legislation which would compel businesses to undertake human rights and environmental due diligence in assessments of their operations and supply chains. It would, in effect, make [access to the EU internal market conditional upon complying with certain core requirements that are explicitly defined in international human rights law](#).

The initiative has received widespread support from civil society organisations and from the EU institutions. [The European Parliament adopted a resolution in March 2021](#) recommending that the Commission initiate a legislative proposal on corporate due diligence and corporate accountability. On 8 February 2022, [over 100 companies](#), investors and business associations, issued a statement calling for mandatory human rights and environmental due diligence as part of the EU's legislative proposal on corporate accountability. Moreover, a recent [YouGov](#) poll commissioned by the [European Coalition for Corporate Justice \(ECCJ\)](#) and other NGOs conducted across nine EU member states found that over 80% of citizens were in favour of robust laws to hold companies accountable for overseas human rights and environmental violations.

The strong support this initiative has received at the institutional, corporate, and public level is indicative of an emerging consensus on the need for more robust corporate accountability legislation across the EU.

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Issues

The existing framework for ensuring the prevention of human rights and environmental abuses in the operations and supply chains of businesses operating in the EU has [proven to be inadequate](#). A [recent European Commission study](#) shows that only one in three businesses in the EU are actively assessing the impact of their operations on human rights and the environment.

This has also been the case at the international level. The [2020 Corporate Human Rights Benchmark](#), which assesses 230 of the largest publicly traded companies in the world on a set of human rights indicators, reveals poor levels of implementation of the UN Guiding Principles on Business and Human Rights. Starkly, nearly half of the companies assessed (46.2%) failed to show any evidence of identifying or mitigating human rights issues in their supply chains.

While there is no single explanation for the poor level of implementation of human rights and environmental standards by businesses across the EU and internationally, the reliance on a voluntary approach to corporate accountability, based on the UN Guiding Principles, has unquestionably contributed to the lassitude which has characterised the response of businesses to date.

Certain EU laws, such as the Non-Financial Reporting Directive, require that large corporations disclose information on the way they operate, manage social and environmental challenges, and respect human rights. However, as is often the case, the intended impact of such legislation across the EU is undermined by each Member State setting its own requirements concerning human rights and the environment. [Furthermore, this highly fragmented regulatory environment](#) has been a source of legal uncertainty for businesses in the EU for many years.

The current model of corporate accountability, which is underpinned by a voluntary approach and a fragmented regulatory framework, has amounted to significant gaps in implementation of corporate due diligence by businesses at the national level. In Ireland, [a recent study found that](#) of the 60 largest publicly listed companies, as well as the 10 largest state-owned enterprises, 34% scored zero on embedding respect for human rights in their operations and supply chains.

While the introduction of robust binding regulations alone will not be a panacea, it is arguably an essential prerequisite for greater corporate accountability when it comes to human rights and the environment.

European Commission Proposal for a Directive on Corporate Sustainability Due Diligence

The Commission's legislative proposal for the new Directive has already generated significant debate across the EU. Despite taking a crucial first step towards mandating human rights and environmental due diligence for businesses operating in the EU, it is widely acknowledged that the draft Directive falls short in many respects. The next section considers some of the strong points of the draft legislation before turning to some of its shortcomings.

Positives

First and foremost, the draft Directive departs from the voluntary approach currently in place by establishing a due diligence duty for businesses to ensure that the human rights and environmental impact of their own operations and supply chains adhere to international standards. [Article 4 sets out](#)

[a comprehensive list of obligations](#), which companies operating in the EU can be expected to carry out.

Furthermore, the [Directive introduces directors' duties for the implementation of corporate due diligence. This is an essential step to ensure that due diligence becomes more than just a 'box ticking exercise'](#) by creating a legal obligation on directors of companies to take the steps necessary to ensure that the activities of companies do not have adverse effects on human rights and the environment.

Moreover, the Directive provides for the establishment of national supervisory authorities that would be responsible for monitoring compliance with the due diligence requirements of the Directive. Significantly, these public oversight bodies would also be equipped with powers to ensure compliance and accountability, including the ability to impose pecuniary and administrative sanctions in cases of non-compliance.

Another welcome development in the draft Directive is the codification of the right to remedy for victims where a company fails to undertake adequate due diligence. [Under Article 22](#), victims are entitled to take legal action through a civil liability mechanism for damages that could have been avoided had appropriate due diligence been undertaken.

Perhaps most significantly, Article 15 of the draft Directive requires that large companies adopt a plan to ensure that their business strategy is compatible with the transition to a sustainable economy and with limiting global warming to 1.5 °C in line with the Paris Agreement. Article 15 also requires companies which have identified climate change as a principal risk to their operations to include emissions reduction objectives in these plans.

Shortcomings

Despite the positive developments outlined above, significant gaps in the draft Directive have been identified which threaten to undermine the overall impact of the initiative and long-term efforts to tackle corporate abuses of power.

While the obligations introduced are welcome, the due diligence rules contained in the Directive would only apply to: EU companies with 500 or more employees and €150 million net turnover; companies in certain high-risk sectors with 250 employees and €40 million net turnover; and a limited number of large non-EU companies. Small and Medium Enterprises (SMEs) are excluded altogether. In other words, the scope of the Directive is limited to about 17,000 firms or [0.2% of EU companies](#). In addition to departing from the UN Guiding Principles on Business and Human Rights (UNGPs), which provide that the corporate responsibility to respect human rights should apply to all enterprises regardless of their size, this provision ignores the fact that staff size and annual turnover are not suitable metrics for measuring how well businesses comply with international standards on human rights and the environment.

While the new law aims to hold companies liable for harms committed at home or abroad by their subsidiaries, contractors and suppliers, a key failing of the proposed Directive is a legal loophole which could make it easier for businesses to evade responsibility for human rights and environmental abuses committed in their supply chains. Essentially, companies could shift their responsibilities onto suppliers lower down the supply chain and avoid legal consequences from victims seeking remedy by inserting certain clauses in contracts.

Another flaw in the draft Directive is the absence of a commitment to engage with those most affected by corporate abuses of power, despite calls from civil society organisations and the European Parliament for the involvement of a wide range of

stakeholders. For example, [the role of trade unions is limited to filing internal complaints about violations](#) rather than being afforded full involvement in the design, monitoring and enforcement of due diligence measures.

[It has also been correctly pointed out that the draft legislation fails to acknowledge how women are disproportionately affected by rights abuses](#) in global supply chains. [Women are often most at risk of corporate human rights abuses](#) in sectors where many of the companies operating are small and medium-sized, such as in the garment industry, horticulture, and tourism sectors. However, the exclusion of SMEs from the scope of the Directive means that women in these sectors cannot rely on the Directive to assert their rights.

Implications for Ireland

In light of the failure of the voluntary approach to corporate accountability, the new draft law represents a crucial step forward by introducing mandatory human rights and environmental due diligence for companies operating in Europe. However, the limited scope of the Directive, legal loopholes, the lack of a requirement to engage with relevant stakeholders, and the lack of gender awareness could seriously undermine its impact in Ireland.

Based on the latest CSO data, [the Irish Coalition for Business and Human Rights estimates that less than 700 Irish companies would be affected](#) by the new law in its current form. The exclusion of 99% of Irish businesses from the scope of the Directive provides little incentive for businesses to clean up supply chains and would essentially mean business-as-usual for the vast majority of companies in Ireland when it comes to due diligence practices vis-à-vis human rights and the environment. Moreover, it is highly possible that the large multinationals operating in Ireland which fall under the scope of the Directive will exploit the duty of care legal loophole, as outlined above.

On a positive note, the draft law provides avenues for victims to seek remedy through the Irish court system from businesses implicated in human rights and environmental abuses. While this is to be welcomed, there are still legitimate concerns around [access to justice](#) for victims, which are not addressed in the draft Directive.

It is also worth noting that there is strong evidence to suggest that harmonisation of the regulatory framework would have minimal costs on business operations and make it easier for businesses to navigate the EU's internal market. The [Commission's study on human rights due diligence](#) found that the relevant procedures set out in the proposed legislation would cost less than 0.14% of the revenues for SMEs and 0.009% for large companies. [Harmonisation of the regulatory framework](#) could therefore be a major boost to the Irish economy by encouraging greater investment in sustainable businesses operating in Ireland.

It is nonetheless revealing that the draft Directive frames EU consumers and businesses as the major beneficiaries of the proposal, while only paying lip service to the rights holders most affected by harmful business practices. Moreover, the fact that the draft Directive does not require engagement with rights holders means that those most affected by harmful corporate conduct in Ireland will have no say in how due diligence is monitored and enforced.

Next Steps

The draft Directive will now proceed through a formal legislative process and will be debated in the European Parliament and the Council of the EU. If it becomes law, EU Member States will have two years to transpose the Directive's requirements into national legislation.

Significant improvements are required to ensure that the legislation does not end up being a toothless 'box ticking exercise' for businesses operating in Ireland and the

EU. Unless steps are taken to address the shortcomings inherent in the draft legislation, businesses operating in the EU and Ireland will continue to evade responsibility and liability for egregious human rights and environmental abuses occurring in their operations and supply chains.

In order to make a significant contribution to fostering a culture of corporate accountability in Ireland and across the EU in the years to come, the draft Directive will require strengthening on a number of levels. Ultimately, the draft Directive should be welcomed as part of a broader paradigm shift towards a model of corporate governance which values human rights and the environment as much as profit.

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