

Position Paper on the Proposal for a Directive on Corporate Sustainability Due Diligence (CSDDD) (COM(2022)71 final)

Key messages

- SMEUnited is in favour of a European due diligence legislation that works and is workable, is proportional to the limited possibilities of SMEs to do due diligence, and effectively shields SMEs who did their due diligence against unfair liability claims. Legislation should ensure a level playing field, both within the EU and with external actors.
- Possible obligations of companies must be formulated in a **legally** certain and **practicable** manner.
- Legal certainty about the applicable material norms must be the starting point. The absence of applicable material norms in the Commission proposal is an existential concern, as legal certainty for companies, supervisory authorities and judges depends on it. The material norms with which the companies will have to comply are unclear and/or unfit for application by companies.
- Regulatory fragmentation will not be avoided by this proposal as many provisions leave large discretionary room with the Member States. In addition there is also the risk of “forum shopping”. Essential elements such as supervision and sanctions should be harmonised on a European level. The proposal should be a regulation rather than a directive.
- The level playing field between EU companies and third country companies is jeopardised by substantially diverging thresholds concerning turnover for EU and third country companies.
- SMEs will be severely affected by the trickle-down effect of the obligations as many of them are in the value chain of larger companies. The possibilities for SMEs to exercise their influence in subcontracting chains or to effectively enforce certain due diligence conditions on to their own business partners are very limited. It is important that SMEs are only subject to obligations that they can actually meet.

- The proposed supporting measures for SMEs to mitigate the impact on their business operations are not sufficient.
- SME should be exempted from the obligation in article 11 to report on the matters covered by this Directive and publish an annual statement on their website.
- The due diligence obligations for SMEs should make a clear distinction between responsibility for their own acts and responsibility for the acts of others in the chain, Extending the due diligence obligation to the entire value chain, upstream and downstream, is a huge extension compared to supply chain (upstream) due diligence. Especially for SMEs this is unmanageable. We propose to limit the scope of obligations to immediate suppliers and to exclude the downstream distribution chain up to the final customer.
- The proposal states that the Commission “may” issue guidelines to support companies or Member State authorities. This instrument is far too weak to guarantee a well-functioning Internal Market, if too much discretionary power is left to the Member States. It should be in any case an obligation for the Commission to issue guidelines on time before the directive enters into force.
- The provisions regarding civil liability (Article 22) and directors’ duty of care (Article 25 and 26) should not be included in the directive.
- The SME toolbox should be ready sufficient time before the entry into force of the Due Diligence Directive. No new obligation should enter into force, as long as the necessary SME tools and support measures are not in place and well-functioning.
- **Supply chains within the EU should be exempted from the directive.** In addition, the European Commission should issue "**white list**" listing states or regions where the legality of the trade can be presumed, which could greatly reduce scrutiny.
- There is no limitation of due diligence to the first tier, i.e. the first stage of the supply chains, but responsibility for the entire value chain. This goes far beyond the direct sphere of influence of a company. For the sake of legal certainty and the practical possibility of exerting influence, **due diligence obligations must at least be limited to this sphere of influence.**

Introduction

On the 23th of February 2022 the European Commission published a proposal for a Directive on Corporate Sustainability Due Diligence¹. According to the Commission the proposal aims to foster sustainable and responsible corporate behaviour throughout global value chains. Companies will be required to identify and, where necessary, prevent, end or mitigate adverse impacts of their activities on human rights, such as child labour and exploitation of workers, and on the environment, for example pollution and biodiversity loss. The objective of the Directive is also to avoid fragmentation of due diligence requirements in the single market by recent national initiatives and create legal certainty for businesses and stakeholders regarding expected behaviour and liability.

Businesses care about the impact they have on the planet and on society. SMEUnited is committed to sustainable, responsible and future-oriented business and encourages initiatives to reduce harmful effects. It supports the intentions of the initiative to improve international human rights and environmental protection through a coherent legal framework. However, responsibility for compliance with environmental standards, social standards and human rights is in the first place an essential task of the states. In addition to the central responsibility of states, companies can provide support within their own sphere of influence. But states must create legal certainty and appropriate framework conditions for companies. **Any regulation must therefore be proportionate and feasible.** The objectives of achieving economic prosperity, social justice and environmental protection in a sustainable and future-oriented way should and could be achieved without additional burdens for SMEs or adverse consequences for them. **Companies should not be held liable for damage in their supply chain if they did not directly cause it or contribute to it, could not reasonably have known about it, or if they took the appropriate due diligence measures to prevent it.** If any due diligence requirements are imposed at all, they should be limited to selected and clearly defined high-risk industries and direct contractual partners ("first tier only"). Value chains are extremely complex. No company can control them outside its immediate sphere of influence.

Violations of human rights and environmental standards occur primarily **in countries that lack functioning regulatory oversight** structures. For the same reason, it is difficult for European companies to gain insight into the affairs of their contract partners located there. Furthermore, no government authorities can be called upon if misconduct is identified. Termination of the business relationship is usually the **only means of exerting pressure** on contract partners who violate human rights, leaving the field to competitors from overseas (with less stringent standards) and burdening local societies with the negative consequences of disengagement.. Thus, clear instructions are needed on how companies should react when they identify

¹ Proposal for a Directive of the European parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, COM(2022)71 final, 23.2.2022 and Annex.

misconduct. Companies cannot be expected to take over the tasks that governments are unable or unwilling to do.

We must be careful about creating new administrative obligations and associated costs for businesses. Especially in the current economic context, where we have been confronted with the corona crisis and the energy and raw materials crisis caused by the Russia-Ukraine conflict. Global supply chains are subject to massive strains already because of the current crises. Any legislative action should be undertaken with reasonableness and in accordance with the principle of proportionality.

In our opinion, this draft directive needs major improvements before it can be implemented by companies in practice. Moreover, in these difficult times, it is important companies are not put at a competitive disadvantage by disproportionate additional administrative burdens.

General Remarks

SMEUnited welcomes that the European Commission has taken the initiative for an approach at European level. As also highlighted by the Commission, there is a need to avoid fragmentation of due diligence obligations in the internal market as a result of recent national initiatives, and to provide legal certainty for companies and stakeholders regarding expected behaviour and liability. A sufficiently harmonised EU-level regulatory framework should also ensure a level playing field for European companies. A fragmented regulatory environment would make it more difficult for companies to operate across borders when they have to take into account differing obligations in national laws. This would also hamper the effective promotion of due diligence. Regulation must be carried out at least at EU level in order to effectively address breaches in international supply chains and third countries.

In order to achieve this goal of a European level approach, which we fully support, it is a fundamental prerequisite that the directive does not leave (too much) national discretion in the implementation of the directive. Member States' discretion on key issues can easily lead to significant differences in national requirements.

In SMEUnited's view these conditions are not fulfilled with the current proposal and regulatory fragmentation will not be avoided. Consequently, the purported objectives, that the proposal will bring legal certainty and a level playing field for businesses, will not be achieved. Moreover, this approach may lead to "forum shopping" by larger enterprises. The use of a Regulation instead of a Directive would address this concern.

Indeed the level playing field within the Internal Market and the proper functioning of the Internal Market, which is the professed legal basis of the Directive, is seriously put into question by:

- 1.) many provisions which leave large discretionary room to the Member States (e.g. Art 9 complaints procedure; Art 13, 17 and 21 on supervisory authorities; Art 20 on sanctions) and
- 2.) the explicit freedom given to Member States to adopt legislation which could go further than the Directive. When a high level of obligations is introduced, as is the case with this Directive, EU wide harmonisation should be the aim. The Directive should go further by harmonising and narrowing the scope for national discretion.

It is important that the companies' obligations are defined exhaustively and with precision so that the requirements will not differ in the national laws. The directive would require each company to apply the detailed requirements of their national legislation in its value chains. As the proposal does not provide coordination of these requirements, this can lead to duplication and additional costs for companies.

SCOPE

- The obligations would apply to EU companies with more than 500 employees and a worldwide turnover of more than EUR 150 million and to EU companies operating in high-risk industries with more than 250 employees and a worldwide turnover of more than EUR 40 million. The thresholds for EU companies are substantially lower and the scope broader than the existing French and German laws and the advice of the Dutch Social Economic Council².

The scope would also cover companies whose activities are based on the legislation of a third country which exceeds the above-mentioned turnover thresholds. The application of the EU framework to companies from third countries operating within the EU is welcomed in principle in the sense of a level playing field. But we find it problematic that, in the case of an EU company, their worldwide turnover would be considered, while in the case of third-country companies, only the turnover generated in the European Union is taken into account. This difference leads to a distortion of competition between EU companies and third country companies. The level playing field between EU companies and third country companies is jeopardised by substantially diverging thresholds for EU and third country companies.

- While the general exemption of SMEs following the thresholds is important, all SMEs in the value chain will be severely affected by the obligation to do due diligence and by the **trickle-down effect**, as many of them operate in the supply chain of large companies and the Commission takes an extensive approach to certain definitions.

The Explanatory Memorandum³ claims that 99% of EU companies are excluded from the due diligence duty. This is manifestly untrue. They might be excluded from the possibility of being

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³ Page 14.

administratively fined, but the Directive evidently shows that it expects the whole value chain to be bound by contractual clauses to do due diligence; equally, contracts may contain civil law fines. Different key provisions in the proposal show that SMEs will be fully affected by this Directive.⁴

Incidentally, the European Commission recognises that additional burdens will be created for European companies, including those that fall outside the personal scope of the draft directive, and that there is a need for SME support. However, we believe the measures will not be sufficient to compensate the additional burden posed upon SME's.

The purported limitation of the scope to large companies does not mean that the effects would not extend to companies outside the actual scope. When obligations are imposed to large companies, the obligations will also be passed on, at least to a certain extent, to SMEs due to subcontracting relationships.

It is appropriate to exclude SMEs from the actual scope, as some obligations such as the establishment of a complaint handling procedure would be unduly burdensome for SMEs.

SMEs, as subcontractors to larger companies, would be subject to various obligations imposed by the companies covered by the directive. This consequence is in fact necessary in order for the company covered by the directive be able to fulfil its own obligations. There is a serious risk that obligations that SMEs cannot fulfil will be passed to them.

Regarding the obligations imposed on SMEs, the only limitation is that the company covered by the directive bears the costs of the independent third-party verification. This limitation is not sufficient to prevent the uncontrolled transfer of obligations to SMEs. The final text should include better safeguards to prevent large companies passing on the brunt of their responsibilities to SMEs.

The possibilities for SMEs to exercise their influence in subcontracting chains or to effectively enforce certain due diligence conditions on to their own business partners are very limited. It is important that SMEs are only subject to obligations that they can actually meet.

Due to the challenges mentioned above, it has to be assured that the regulatory burden is not transferred to SMEs. The burden on SMEs can be managed by defining what obligations a company covered by the directive can impose to a business partner that is a SME. However, SMEs must not be pushed out of supply chains in favor of larger companies that can benefit more efficiently from economies of scale in a due diligence system.

⁴ See for example our comments on articles 7, 8, 11 and 14.

SMEs need to be effectively supported, whether or not they fall within the scope of a mandatory framework. Whether the envisaged accompanying measures can actually remedy this situation must be questioned. More concrete details about these measures are desirable (timeframe for adoption, obligations for the EC).

In addition, in our view due diligence should only apply to activities carried out by companies from third countries with which the company has a business relationship. EU-based companies should be presumed to act in accordance with national and Union law. **Supply chains within the EU should be exempted from the directive.** In addition, the European Commission should issue "white list" listing states or regions where the legality of the trade can be presumed, which could greatly reduce scrutiny.

Lack of Legal certainty

In the Explanatory Memorandum ⁵ the Commission perfectly describes the difficulties enterprises encounter when they want to apply due diligence: "... companies may also face difficulties when considering to use the value chain due diligence for their activities. Such difficulties can be for instance due to lack of **legal clarity** regarding corporate due diligence obligations, **complexity of value chains, market pressure, information deficiencies, and costs.** As a consequence, the benefits of due diligence are not widespread among European companies and across economic sectors." SMEUnited fully agrees with this analysis. It is therefore also more than disappointing that the Commission's proposal does not remedy these difficulties, on the contrary.

The definition of the scope is not clear (e.g. Art. 2.1), neither the ones of "businesses relationship" and "established business relationship" which are in addition operationally difficult to apply. See also our comments on Article 3 "Definitions".

Many terms are also unclear: "appropriate measure", "necessary", "not negligible", "ancillary", "adverse environmental and human rights impact", "severe adverse impact", "proportionate", "reasonable timelines", "other entities", "partners",... If there are legal and financial repercussions, companies need legal clarity and these norms need to be properly defined.

The definition of "appropriate measures" does not include essential elements of the Explanatory Memorandum.

In addition the material norms with which the companies will have to comply are unclear and/or unfit for application by companies. The six pages of international norms in the annex are mostly government-to-government standards. It has to be noted that the annex was removed from the draft of the own initiative report of the European Parliament. The absence of applicable

⁵ Page 2.

material norms is an existential concern, as legal certainty for companies, supervisory authorities and judges depends on it.

It is important that regulation provides a clear operating environment for companies. The objectives of the directive can be most effectively achieved through obligations that are realistic for the companies. Since breaches of the obligations would lead to sanctions, it is important for the legal certainty of companies that the directive clearly sets out what measures companies must take to fulfil their obligations.

Civil liability

We consider that the provision regarding civil liability (Article 22) should not be included in the directive or at least should be substantially amended. It is unclear how the responsibility would be shared between different parties in the value chain. It is therefore possible that liability will be cumulated to companies whose national law the victims consider to be the most favorable to them. The provision is also contrary to the general principles that liability of damages requires adequate causation, and that the causer of damage is liable for compensating the damages.

Companies can be held liable for breaches caused by third parties and the resulting damage. The prerequisite that a breach of duty must be causal for the damage, or the question of what type of intent must be present for the claim for damages, is not addressed in the directive.

Furthermore, companies should not be held liable for damage in their supply chain if they have not caused it directly or if they have taken the appropriate due diligence measures to prevent it. Those who can prove that all requirements have been met must be exempt from liability ("obligation of means", recognition of compliance measures).

Furthermore, it must be clarified how the liability rules apply to all links in the supply chain (joint and several liability? recourse? etc.). The relationship between damages under Art. 8 (3) and Art. 22 must be clarified.

Measures to support SMEs.

It is very important that the proposal includes measures to support SMEs. Supporting SMEs is essential to effectively integrate the requirements into companies' value chains that includes SMEs. However, the measures to support SMEs are not sufficient and the provisions to shield SMEs from disproportionate requirements are vague and don't provide any certainty.

Legal certainty and expertise for SMEs can be increased through guidance and advice. It should be ensured that public authorities (Member States, European Commission, ...) provide adequate support, advice, and guidance to SMEs. We consider the requirement for Member States to set up websites to provide guidance to SMEs to be important in this regard.

The proposed support measures such as "dedicated websites, platforms or portals" are necessary, but it must be ensured that they can really provide practical advice to SMEs. Too often, these types of tools are not accessible to SMEs: too complex and not sufficiently educational. This is also confirmed by academic research.⁶

Moreover, **SMEs need support to identify and mitigate the risk of their supply chains and reduce the adverse human rights and environmental impact. It is important that the final version of the directive takes this element duly into account. SMEUnited already highlighted this years ago, but the Commission failed to deliver.**⁷

The directive would require companies to seek contractual assurances from its business partners, where relevant, to ensure compliance with the company's code of conduct and prevention action plan (Article 7(2) point (b) and Article 8(3) point (c)).

There is a risk that under the guise of the obligation to seek contractual assurances the larger companies will transfer their own obligations and burden to SMEs. Therefore, it is important that the company seeking contractual assurances has an obligation to provide targeted and proportionate support to the SME with which it has an established business relationship (Article 7(2) point (d) and Article 8(3) point (e)). Also, we consider that the requirements of fair, reasonable and non-discriminatory terms to be important when contractual assurances are obtained from SME (Article 7(4) and Article 8(5) although more precise definitions are needed.

Although the above measures are important, as such they are too vague. The measures do not indicate how the support to SMEs should be provided, nor do they indicate what conditions are

⁶ See: **The push for human rights and environmental due diligence: What is at stake for SMEs?** Authors: Dr. Boris Verbrugge, Diana Pietrzak, & Vincent Dupont (HIVA-KU Leuven), March 2022.

⁷ See our 2011 Position Paper: "In the last years more and more SME have become active at the international market or in markets in third countries, in order to remain competitive with the big international chains and companies. Our small enterprises are fully committed to respect the human rights. But they do not have the means, the knowledge or the power to guarantee that their providers or sub-contractors in third countries are respecting the human rights. Often they work with intermediary persons and is control (through independent advisors, company visits collaborators) extremely difficult to realise. Since many years UEAPME, also in the framework of the Multistakeholder Forum on CSR, has tried to solve this dilemma together with NGOs who do have the necessary know –how in this field. Unfortunately these NGOs neither do have the means to help our SMEs nor are not even allowed to operate in the most problematic third countries. That's why **UEAPME is asking to pool together resources: the U.N, the ILO, the European Commission or the EU Embassies should provide databases to our small enterprises with reliable counterparts in third countries. Public authorities could in addition support SMEs and raise awareness amongst them concerning international trade and human rights.**"

reasonable for SMEs. Furthermore, there is no remedy for SMEs if disproportionate obligations are imposed on them.

The final version should take into account other proposals such as the deforestation regulation where – to prevent a large administrative burden and aid SMEs- the Council and Parliament want to include provisions that allow SMEs to use supply chain information from larger companies, thus avoiding double work.

Coherence at EU level

There is a risk of over- and double regulation. The EU is currently working on several parallel projects on sustainable corporate governance (e.g. Sustainable Finance, Taxonomy, Corporate Sustainability Reporting Directive, Deforestation Regulation or Conflict Minerals Regulation, ban on forced labour products). All these projects need to be coordinated and harmonised in terms of content and timing in order to avoid duplications.

It is essential that the Commission monitors and substantiates the coherence with these existing and forthcoming initiatives more comprehensively, and that it monitors compliance with the OECD guidelines and the UNGPs. This should prevent different requirements from leading to an accumulation of obligations for companies.

ANNEX - Comments on the Articles

Art.1 Subject matter

Art 1.1.

The Directive lays down rules on obligations and liability for companies.

It introduces the application to the whole value chain, upstream and downstream. This includes "actual negative impacts" as well as "potential negative impacts". This is an enormous extension compared to previous approaches which were in addition mainly supply chain (upstream) oriented.

In order to maintain proportionality and practicability and as is the case in the existing legislations in Germany and France, "value chain" should be replaced by "supply chain". See also article 3.g.

Proposed amendment:

"1. This Directive lays down rules

- (a) on obligations for companies regarding actual and potential human rights adverse impacts and environmental adverse impacts, with respect to their own operations, the operations of their subsidiaries, and the ~~value~~ **supply** chain operations carried out by entities with whom the company has an established business relationship and
- (b) ...

In addition, in our view due diligence should only apply to activities carried out by companies from third countries with which the company has a business relationship. EU-based companies should be presumed to act in accordance with national and Union law. Supply chains within the EU should be exempted from the directive. In addition, the European Commission should issue a "**white list**" of states or regions where the legality of the trade can be presumed, which could greatly reduce scrutiny. (See also: support measures)

While we fully agree that a periodic reassessment of the business relationships needs to be carried out on a regular basis, the specification of a twelve-month minimum interval is excessive and should be left to the companies' assessment.

Art.2 Scope

Art 2.1

- As already mentioned above, the thresholds for EU companies (>500 employees, >150 mln turnover; >250 employees and >40 mln turnover for risk sectors) are substantially lower than the existing national legislations.
- The so-called risk sectors have a very wide scope: the manufacture and trade of textiles, leather and related footwear, agriculture, forestry, fisheries, food products, beverages, wood, all mineral resources, basic metal products, construction materials, fuels, chemicals and other intermediate products. This corresponds with the sectors for which the OECD has developed sectoral due diligence guidance. These sectors include many SMEs. The financial sector is not considered a high risk sector, although there is an OECD sectoral guidance. The directive is not clear about the definition of the “value chain of regulated financial undertakings”. Indeed recital (19) states that “Clients that are households and natural persons not acting in a professional or business capacity, as well as small and medium sized undertakings, should not be considered to be part of the value chain.” Self-employed persons are according to the first part of this sentence, included in the value chain, as they are “acting in a professional or business capacity” while according to the second part they are excluded as they are also an SME.

Proposed amendment:

(19) “Clients that are households and natural persons ~~not acting in a professional or business capacity~~, as well as small and medium sized undertakings **including self-employed**, should not be considered to be part of the value chain.”

- Nowhere in the directive an exact definition of these risk sectors is given, which will lead to **legal uncertainty**. Even more, the recital (18) of the directive give an even wider scope: “It should encompass upstream established direct and indirect business relationships that design, extract, manufacture, transport, store and supply raw material, products, parts of products, or provide services to the company that are necessary to carry out the company’s activities, and also downstream relationships, including established direct and indirect business relationships, that use or receive products, parts of products or services from the company up to the end of life of the product, including inter alia the distribution of the product to retailers, the transport and storage of the product, dismantling of the product, its recycling, composting or landfilling.” What are services **necessary to carry out another company’s activity**? This should be clearly defined, but as this is quite impossible, this recital should be deleted.

Proposed amendment

Delete recital 18

Art. 2.2

- As said before it is essential for the competitiveness of the European businesses that businesses from third countries are subject to the scope on the same footing as EU companies. However, the thresholds for non-EU companies are much higher than for EU companies (EU: 150 mln worldwide turnover; third country: 150 mln *EU* turnover). This means that in practice, the EU companies which have to comply with the directive will mostly be much “smaller” than the third country companies and the Explanatory Memorandum recognises this⁸, while somewhere else⁹ it states that “[Union legislation] would also include third-country companies operating in the Union market, based on similar turnover criterion”. The main argument put forward in the proposal¹⁰ is that a relatively high turnover may have an effect on the Internal Market, which creates a territorial connection. The problem here is that the need to demonstrate a territorial connection forces the Directive, the explicit basis of which is the functioning of the Internal Market, to introduce a manifest discrimination of EU companies and a future disruption of the Internal Market. This discrimination should be avoided.
- As it may be clear that we welcome the application of the EU framework to companies from third countries operating in the EU, at the same time we have strong doubts about the enforceability.

Art 2.4

- The Member State competent to regulate is the Member State in which the company has its registered office. This opens the possibilities for **forum shopping** as the Directive leaves open possibilities for diverging national interpretation and implementation, including sanctions.

Art 3 Definitions

As already mentioned, the European Commission's extensive approach to certain definitions leads to the mechanical inclusion of many SMEs in the due diligence obligations and exposes them to unfair trickle-down effects.

⁸ Explanatory Memorandum page 16: “... the two size criteria applicable to EU companies, even if cumulative, will result in still covering relatively smaller companies compared to non-EU companies due to the fact that, in their case, the entire worldwide net turnover of the company is to be taken into account.”

⁹ Explanatory Memorandum page 3.

¹⁰ Explanatory Memorandum page 15 and 16 and Recital (24).

Art 3(a) Company

- The directive refers to legal persons as listed in the Annexes of Directive 2013/34/EU and a long very detailed list of regulated financial undertakings (financial sector and insurance and pension funds).
- The question is what are the **consequences** of the Directive for enterprises which are not a legal person listed in the Annexes of Directive 2013/34/EU and don't have a company statute as for example **self-employed**. This should be clearly assessed and defined also for non-risk sectors.

Art 3(b) and (c)

- The “**Adverse environmental impact**” and “adverse human rights impact” definitions are based on an annex of 6 pages of international rights and (often political) declarations. The material norms with which the companies will have to comply are unclear and/or **unfit for application by companies**. The six pages of international norms in the annex are mostly government-to-government standards. It is particularly constraining for SMEs to be subject to and have to refer to a list of conventions that are not ratified by all countries. We ask therefore to delete the reference to international conventions or to specify the list of applicable rights. It has to be noted that the annex was removed from the own initiative report of the European Parliament. **The absence of applicable material norms is an existential concern, as legal certainty for companies, supervisory authorities and judges depends on it.**
- These rights are not formulated in such a way that they can be invoked in a private – private relation. Does this create sufficient legal certainty that they can be applied by companies, supervisors and judges? How large is the discretionary room for interpretation, also taking into account the ‘obligation of means’ approach in the Explanatory Memorandum.

Art 3(e)

- The definition of “**Business relationship**” is very broad: “*business operations related to the products or services*”. A business relation can exist very far in the chain, e.g. when a company provides information on a product related to repair of a very old product or to its recycling. This is also referred to in recital (18) (see also our comments above on art.2.1). What about self-employed without a company statute, as they are not “companies”?

Art 3 (f)

- “**Established business relationship**”:

This definition introduces a great deal of legal uncertainty for SME partners:

- What is the meaning of “*which is or is expected to be lasting*”? What is “lasting”? and “*direct*” or “*indirect*”? How can an “established relationship be indirect taken into account the definition of business relationship of 3(e)?

- What is the meaning of “not a negligible or ancillary part of the value chain”: this leaves a large room for interpretation, and the text provides no criteria at all.

The "well-established" character is very subjective and risks being left to the free interpretation of the company subject to the obligations of the directive, as well as supervisors and judges.¹¹

Therefore, only the relationship of contractor or subcontractor as defined in art 3(e) should prevail. We propose to delete the definition as well as any reference in this Directive to the "well-established" nature of the commercial relationship.

Proposed amendment

Delete Art 3(f) and all references to it in the Directive.

Art 3 (g)

- **“Value chain”**: upstream and downstream, from the development of the product to its disposal; this is a very substantial extension of the supply-chain approach mostly applied until now, e.g. in the German Lieferkettensorgfaltspflichtengesetz.
- The term covers the supply chain as well as the distribution chain and all other suppliers, refiners etc. which is a source of great legal uncertainty for SMEs. The value chain is not only defined in a straight line, but also with all the cross-connections that complete the product. Companies in the distribution chain are not necessarily bound by a contract with the company to which the duty of care applies. The "indirect partners" and the "direct partners" are therefore included, which is confusing. The responsibility of the company can only be engaged in the context of a contractual relationship, otherwise there is no legal proof of its involvement in the value chain. We therefore propose to limit the scope of obligations to immediate suppliers and to exclude the downstream distribution chain up to the final customer. The value chain is too broad and should be replaced by “supply chain” in the directive.
- Recital 17, p.32: ‘throughout the life cycle of production and use and disposal of product or provision of services, at the level of own operations, subsidiaries and in value chains’. Recital 18 also gives a very wide, all-encompassing description of the value chain.¹²

¹¹ The French Constitutional Council, in its decision n°2017-750 DC of 23 March 2017, noted the imprecision of the "well-established" character of a commercial relationship. It considers that the perimeter of the economic partners to be taken into account for the elaboration and implementation of the due diligence plan must be clearly defined, in order to avoid any legal vacuum likely to be in contradiction with the Constitution. In practice, this relationship is not formalised by a contract and therefore offers no legal support, contractual guarantee or possibility of recourse to the partner company.

¹² “The value chain should cover activities related to the production of a good or provision of services by a company, including the development of the product or the service and the use and disposal of the product as well as the related activities of established business relationships of the company. It should encompass upstream established direct and indirect business relationships that design, extract, manufacture, transport, store and supply raw material,

- What is a 'group'? Does this refer to Directive 2013/34/EU?
- The value chain of financial institutions does not include SMEs; for other companies, SMEs are not excluded?

Proposed amendment

- To delete Art. 3.g.
- To replace 'value chain' by 'supply chain' throughout the directive.

Art 3(h)

- **"Independent third party verification"**: it should be highlighted that this implies substantial extra cost for companies. No estimates are available at this moment and a proper cost analysis is missing. It is essential to ensure that the market is open to all independent third parties (financial auditors, certification bodies, rating agencies). It is indeed desirable that the market is not, de facto, reserved for statutory auditors or audit firms that verify the financial statements and the management report and to avoid any concentration that would generate additional costs. It is also linked to the CSRD.

Art 3 (j)

- Inclusion of collective initiatives into the definition is important. Collective initiatives will give SMEs much more leverage to truly make a difference. And allow them to share the administrative burden.

Art 3(l)

- **"Severe adverse impact"**: This is a very general definition, not precise. The "serious" nature of the impact is unclear as it can be very difficult to assess the degree of impact. While there are no legal safeguards to define these notions of impact on a large number of people or a large part of the environment, it is not consistent to make companies liable for this impact. We propose to delete this definition which is only present in article 6.2 and 9.4b of the text (and recitals 21, 31 and 42).

Proposed amendment

- Delete Article 3.l and the references in the recitals 21, 31 and 42 and the articles 6.2 and 9.4b.

products, parts of products, or provide services to the company that are necessary to carry out the company's activities, and also downstream relationships, including established direct and indirect business relationships, that use or receive products, parts of products or services from the company up to the end of life of the product, including inter alia the distribution of the product to retailers, the transport and storage of the product, dismantling of the product, its recycling, composting or landfilling."

Art 3(n)

- Definition of “**stakeholders**”: any right or interest could be affected (*‘other individuals whose rights or interests are or could be affected’*). These terms, which introduce too much legal uncertainty for companies, should be deleted and it should be made clear exactly what is meant by the concept of stakeholders.
- A reasonable delimitation of stakeholders is needed and further delimitation is required: the requirement of a substantive interest, a substantiated complaint. In addition there should be guarantees against frivolous claims.

Art 3(q)

- “**Appropriate measure**”: also this definition gives a large room for interpretation. This definition needs clarification as it is introducing concepts that are not very legally sound, such as *“the likelihood of the adverse impact”* or *“the degree of severity”*. In addition, too much room for interpretation by Member States may jeopardize the stated aim of the Directive, which is creating a better functioning Internal Market. A more unified approach in the EU should therefore be envisaged.
Recital 15 states: *‘This Directive should not require companies to guarantee, in all circumstances, that adverse impacts will never occur or that they will be stopped’* and also that *“Therefor, the main obligations in this Directive should be ‘obligations of means’.”*
- In order to provide more clarity in the definition of appropriate measures, these elements of recitals 15 should be integrated in the definition.
- The responsibility should not be shifted from the causing entity to the enterprise with which it has a business relationship. This should be explicitly incorporated in art. 3.q as it is currently too vague.

Art. 4 Due diligence

Art 4.1

- This article is again proof that it is appropriate to exclude SMEs from the actual scope, as the obligation to establish and maintain a complaint handling procedure would be unduly burdensome and not proportionate for SMEs.

Art 4.2

- It is positive that it is clearly stated that competition law should not hamper cooperation of companies.
- Nevertheless, the provisions on due diligence must be specified in concrete terms in order to create legal certainty. If a due diligence obligation is introduced, it must be practicable, proportionate, and reasonable. Consequently, this implicates that companies should - if at all - only be held responsible for those violations of human

rights and environmental standards of which they are or should be aware of and which - and this is particularly important - they can actually influence.

- There is no limitation of due diligence to the first tier, i.e. the first stage of the supply chains, but responsibility for the entire value chain. This goes far beyond the direct sphere of influence of a company. For the sake of legal certainty and the practical possibility of exerting influence, **due diligence obligations must at least be limited to this sphere of influence.**
- Finally, the proposal does not give an answer to the important question of how compliance with the various obligations can be proofed. Will confirmations from suppliers suffice? Under what conditions is good faith protection given? Any possible answer will inevitably imply a huge amount of administrative workload.

Art 5 Integrating due diligence into companies' policies

- Article 5 requires Member States to ensure that "companies integrate due diligence into all their corporate policies", including "a code of conduct" which application should be extended to established business relationships. This policy should be updated annually.
- Although this article does not apply to SMEs, it has severe consequences for the SMEs in the supply chain of companies which are in the scope of the Directive. This obligation has to be deleted as obliging SMEs to respect a large company's (or even several large companies') code of conduct places them in a very uncertain subordination situation.
- It is disproportionate to ask for an annual update of the policy and therefore of the company's control over its "well-established commercial relations". In our view the reference to "well-established commercial relations" should be deleted.

Art 6 Identifying actual and potential adverse impacts

Art 6.1

- "Identifying adverse impact": what are "appropriate measures"? See our remark on definition under Article 3 (q).

Art 6.2

- Smaller high risk companies shall only be required to identify severe adverse impacts (definition of severe in Art 3.l).

Art 6.3

- Financial sector due diligence has to be provided before providing the service. It should be made clear that this article does not apply to SMEs.

Art 6.4

- The definition of stakeholders should be clarified (see above: Article 3(n)). In addition, stakeholder consultations should only be carried out if they are necessary and purposeful.

Art 7 Preventing potential adverse impact

Art 7.1

- “Appropriate measures” should be better defined: see above Article 3(q).
- What are “impacts that should have been identified”?

Art 7.2.a

- What is the definition of “necessary”?
- What are “reasonable timelines”? A unified EU approach would be desirable for a good functioning of the Internal Market.

Art 7.2.b

- “Seek contractual assurances, prevention action plan, contractual cascading from a direct business relationship”. This is formulated as an obligation of means (seek). It should be stated more clearly under what conditions the Directive considers the obligation of means to be reasonably fulfilled.
- **The contractual assurances and contractual cascading imply that de facto due diligence rules will also fully apply to SMEs.** In practice, contractual assurances and contractual cascading are highly problematic as far as monitoring and enforcing of assurances is concerned.
- Obliging business partners to respect the company's code of conduct places SMEs in a very uncertain subordination situation..

Proposed amendment

To delete article 7.2.b or at least exempt SMEs.

Art 7.2.c

- What is the definition of “necessary”?

Art 7.2.d

- Companies ‘shall’ provide targeted and proportionate support to SMEs if compliance would jeopardize its viability. This would imply substantial administrative burdens. Such cost should be borne by the authorities, not by companies.

- The proposed solution of "targeted and proportionate support" may have the opposite effect. Indeed, imposing financial support to SMEs on large companies risks directing them towards large partners for whom they will have neither efforts nor costs to incur.
- They are also only obliged to when the compliance obligation would 'jeopardise the viability of the SME'. We find it very far-reaching that there should only be intervention when the viability of a company is at stake. On the one hand, this indicates that the European Commission is well aware of what the impact on SMEs could be; on the other hand, proportional support should also be possible when the impact is substantial but not yet life-threatening. If legal obligations are that far reaching that the viability of SMEs are in danger, this means that the legislation is not proportionate and that the public authorities should intervene and support the SMEs.

Art 7.2.e

- What are "other entities"? Other companies or also other entities?
- The Directive requires the company to collaborate with third 'entities' to stop adverse impact if other action is not effective. However no specification of the "collaboration" is provided.

Art 7.3

- The company may seek to conclude a contract with a partner with whom it has an indirect relationship (<-> 7.2.b) for adverse impacts that could not otherwise be addressed. This is also formulated as an obligation of means.
- The term "partner" is not defined; is this an (indirect) established business relationship as defined under 3.f? If not, what else?

Art 7.4

- **Art 7.4 is one of the provisions which clearly shows that SMEs will be fully affected by this Directive.** In practice, due diligence obligations will be transferred via contract clauses to all SMEs upstream and downstream. Clauses will be accompanied by fines. The Directive will not directly affect SMEs, but indirectly, via their contract partners, they will be subject to all due diligence burdens, including fines.
- Contract terms with SMEs should be "*fair, reasonable and non-discriminatory*". These terms need to be defined and made clearer. If Member States are allowed to define this, the functioning of the Internal Market may be jeopardised, as standards may vary per Member State. Clear definitions are also necessary as otherwise the provision has no practical effect shielding SMEs from disproportionate contract terms. See also Art. 12 on Commission guidance on voluntary model contract clauses.
- The cost of verification of the SME action should be borne by the company with which it has a relation. If the SME cannot pay for costs related to new legislation, it is logical that the government provides for support, not contract partners. See 14.2 on financial support by Member States.

Art 7.5

- This article states that “Member States shall provide for the availability of an option to terminate the business relationship in contracts governed by their laws.” It has to be prevented that this article can be used as a pretext to terminate business contracts. Moreover, we believe this article could be used as a means of pressure to cascade responsibilities down the value chain.
- Forbidding to extend the existing relationship when adverse impacts cannot be prevented or mitigated can be counterproductive in solving the problem. To terminate a business relationship can only be done in order to eliminate the risk of an administrative penalty or even civil liability. One has also to take into account that by terminating a business relationship the business field is left to other players. The Ruggie Principles (e.g. 19) provide broad discretionary powers to companies concerning the approach companies should take.

Art 8 Bringing actual adverse impacts to an end

- A temporary suspension or even termination of a business relationship may under certain circumstances constitute a breach of contract under the relevant statutory provisions and thus give rise to claims for damages. This should be taken into account when concluding the contract and can thus be problematic in the case of old contracts and contracts to which the law of a third country is applicable.

Art 8.1

- Same comments as on Article 7.1

Art 8.3.a

- “Proportionate” should be better defined.

Art 8.3.b - f

- See 7.2.a - e
- See art. 12 on Commission guidance on voluntary model contract clauses.

Art 8.4

- See 7.3

Art 8.5

- Same remarks as Article 7.4

Art 8.6

- See 7.5
- Same remarks as Article 7.5

Art 9 Complaints procedure

- The complaints procedure and the definition of legitimate concerns should be determined at EU level to guarantee the well-functioning of the Internal Market.
- Legitimate concerns could better be defined as substantiated concerns (as in Art.19) or as substantive interest. In fact, an interest should be both legitimate and substantive, as is indicated in Art 19.5.
- The complaints procedure should contain a protection against frivolous claims.

Art 10 Monitoring

- This provision also implies that SMEs will be substantially affected by this Directive.
- The specification of a 12-month interval to carry out an assessment is excessive. The frequency of the assessment should depend on the specific circumstances and be risk-based. In many situations the circumstances will not have substantially changed from the previous year; a mandatory full re-assessment would then be senseless.

Art 11 Communicating

- The Title “Communicating” is misleading and a real euphemism. It should clearly say that it is about “Reporting”.
- Also this provision implies that SMEs will be substantially and excessively affected by this Directive. It introduces an obligation for all companies (meaning with company statute) “to report on the matters covered by this Directive by publishing an annual statement on their website in a language customary in the sphere of international business”. This obligation was already present in Directive 2013/34/EU, but small and medium-sized enterprises were exempted from certain statements in the annual report (key performance indicators of a financial and non-financial nature relating to environmental and personnel issues). Article 11 would remove this exemption and make this report mandatory for all companies.
- This article is a perfect example of the unworldliness of the Commission. Indeed not all companies / SMEs have a website, let alone the human and financial resources to produce an annual report. Moreover, the reference to “a language customary in the sphere of international business”, although imprecise, may imply the use of English or

any other “international” language, which would require SMEs to have a website in several languages, which is more expensive. This goes against the fundamental freedom of an entrepreneur on how to present its company to the outside world. It is indeed presumptuous for a company that is not international active to present itself in English. In addition, the use of a non-local language can have serious legal consequences in the field of consumer protection as the use of that language is an indication, that a company is selling outside its country.

- Article 11 is also very imprecise in its reference to "matters covered by the Directive". This reference introduces a major uncertainty for businesses, also taking into account the Explanatory memorandum of the CSRD stating that: “The current situation is also problematic for companies that have to report. The lack of precision in the current requirements, ..., make it difficult for companies to know exactly what information they should report.”¹³
- The Regulatory Scrutiny Board opinion is also very clear on the Impact Assessment: “The impacts are not assessed in a sufficiently complete, balanced and neutral way.”¹⁴
- This additional reporting goes against one of the main reasons why the CSRD has been proposed, namely, to reduce the number of reporting requests. The provisions in the CSDDD and the CSRD should be fully compatible and not contain any duplication.
- As a Delegated Act will determine content and criteria for the reporting this will require coordination of the content and the timeframe.
- The relationship with the CSRD, SFDR and taxonomy needs to be clarified and streamlined. In particular, the content and timeframe of the Delegated Acts require coordination.
- This article should be deleted, or in any case SMEs should be exempted.

Proposed amendment

Communicating Reporting

“Member States shall ensure that companies ~~that are not subject to reporting requirements under Articles 19a and 29a of Directive 2013/34/EU~~ **referred to in Article 2** report on the matters covered by this Directive by publishing on their website an annual statement in a language customary in the sphere of international business. The statement shall be published by 30 April each year, covering the previous calendar year.”

¹³ COM(2021)189 page 3.

¹⁴ [https://ec.europa.eu/transparency/documents-register/detail?ref=COM\(2022\)71&lang=en](https://ec.europa.eu/transparency/documents-register/detail?ref=COM(2022)71&lang=en) See : REGULATORY SCRUTINY BOARD OPINION, SEC(2022) 95

Art 12 Model contract clauses

- We welcome the commitment of the Commission to adopt guidance for voluntary model contract clauses. However, publishing guidance should be an obligation for the Commission. Furthermore, such guidance should provide sufficient legal certainty. Legal certainty on this point is essential, taking into account the importance of these clauses as highlighted in Art. 22.2.
- It has to be ensured that the guidelines are published well before the directive is applicable, giving sufficient time to organise awareness rising campaigns and for a practicable implementation. This should be done by defining a mandatory timetable. The involvement of the representative business organisations should also be made mandatory in order to ensure that they are not imposed and inspired by large companies only.

Art 13 Guidelines

- The Commission may issue guidelines to support companies or Member State authorities. This instrument is far too weak to guarantee a well-functioning Internal Market, if too much discretionary power is left to the Member States. It should be in any case an obligation for the Commission to issue guidelines on time before the directive enters into force.
- In addition, taken into account the definition of 'stakeholder' in Article 3.n. SME organisations and companies in general will apparently not be consulted when drafting the Guidelines. However it is imperative that SME organisations and companies in general will be fully involved in the drafting process.

Proposed amendment

*"In order to provide support to companies or to Member State authorities on how companies should fulfil their due diligence obligations, the Commission, in consultation with Member States, **representative SME organisations, business organisations** and stakeholders, the European Union Agency for Fundamental Rights, the European Environment Agency, and where appropriate with international bodies having expertise in due diligence, **shall** issue guidelines, including for specific sectors or specific adverse impacts."*

Article 14 Accompanying measures

Article 14 proposes the establishment of accompanying measures. Particular attention is paid to SMEs in the value chains of enterprises and it is mentioned in particular that Member States may financially support SMEs. SMEUnited warmly welcomes this consideration of the specificity of SMEs and the need to support them.

The proposed support measures such as "dedicated websites, platforms or portals" are necessary, but it must be ensured that they can really provide practical advice to SMEs. Too often, these types of tools are not accessible to SMEs: too complex and not sufficiently educational. This is also confirmed by academic research.¹⁵

Among the accompanying measures mentioned in Article 14 and in recitals 47 and 48, SMEUnited would like the observatory for the transparency of value chains and the "toolboxes" to be implemented. It has to be noted that the "Observatory" is nowhere mentioned in the legal text of the Directive. This should be corrected.

With regard to the accompanying measures mentioned in Article 14 and in Recitals 47 and 48, the SMEUnited insist that the Observatory for the transparency of value chains and the "toolboxes" to be set up, are running before the implementation of the regulatory provisions. Indeed, if these accompanying measures do not precede the implementation, SMEs risk being the first victims of unfair competition from large companies. The unequal bargaining power of SMEs vis-à-vis large companies makes them dependent on the contractual terms imposed by the latter. Without accompanying measures, SMEs will be all the more subject to information asymmetry when contracting the commercial relationship. Large companies will take advantage of this asymmetry to adapt to the requirements and this will be to the detriment of the smaller co-contracting companies.

Furthermore, it has to be ensured that the financial support is effective. It must therefore be imposed on the Member States.

Art 14.1

- This provision explicitly shows that SMEs are fully affected by this Directive: 'Special consideration shall be given to SMEs present in the value chains'. We welcome that Member States will have the obligation to set up dedicated websites.

Art 14.2

- Member States may financially support SMEs. Why are article 7.4 and 8.5 concerning support by larger companies then necessary?
- This provision again indicate explicitly that SMEs are affected by this Directive.

Art 14.3

- The Commission may facilitate joint stakeholder initiatives. Well-designed common efforts such as sectoral joint stakeholder initiatives are of particular relevance to SMEs, which themselves do not have sufficient market power and leverage to exercise the influence which is expected from them. It is therefore of particular relevance that with

¹⁵ See: **The push for human rights and environmental due diligence: What is at stake for SMEs?**
Authors: Dr. Boris Verbrugge, Diana Pietrzak, & Vincent Dupont (HIVA-KU Leuven), March 2022.

Commission guidance, an effective model for joint stakeholder initiatives is developed, which also shelters companies which adhere to them against unfair claims.

- In 14.3 the facilitation is not defined or limited. However, in 14.4, the facilitation seems to be limited to dissemination of information. The **facilitation by the Commission should be more substantive.**
- See also Explanatory Memorandum p.17 and recital 37.

Art 14.4

- The Directive limits the facilitation to the provision of information. That is not enough. It seems to indicate that the Commission has a very narrow approach to collective initiatives (see 14.3).
- Concrete amendments should be formulated, elaborating on the way the Commission should facilitate collective initiatives.
- Also, an amendment could be proposed elaborating the 'learning process' which should be encouraged. See art. 18.

Art 15 Combating climate change

- EU companies with >500 employees/>150 mln turnover and third country companies with >150 mln EU turnover must have a plan on to comply with the Paris Agreement and especially on the CO2 footprint.
- Consequently SMEs are out of the scope of this article. **As Member States have to control the plan, this is again an argument that it makes no sense to include all SMEs in the scope of the directive, as it is impossible for Member States to check the millions of plans.** Nevertheless we have to stress here again, that EU companies are in a disadvantaged position vis-à-vis third country companies. See also our comments on art. 2.2.
- Art. 15.2 states that if climate change is a principal risk/impact, the plan must include emission reduction objectives. It has to be noted that it is not specified which kind of emissions.
- Art. 15.3 states that the fulfillment of these obligations should be taken into account when setting variable remunerations for directors. In our view it is important to strike a balance between the regulation of remuneration mechanisms and the freedom of companies to define their own remuneration structures.
However, it has to be noted that companies' choices of remuneration systems may take into account long-term perspectives and are justified in this respect. Consequently encouraging self-regulation by entrepreneurs without imposing legislation in this field would be an effective tool for the establishment of balanced remuneration systems.

Art 16 Authorised representative

- Third country companies have to designate an authorised representative in one of the Member States.
- As the Directive leaves large discretionary freedom to the Member States, the choice of where to register the authorised representative risk in our view substantially impact the level playing field.

Art 17 Supervisory authorities

- According to the Explanatory Memorandum¹⁶ the Directive will leave it up to the Member States how to organise enforcement. We fear that this will **jeopardise the level playing field**. The element of supervision is one of the key elements of the Directive. It is unacceptable that wide divergences in implementation across Member States would emerge, however this is rather likely on the basis of the current proposal.
- Even if the supervision will be limited to the larger companies as defined in article 2, it will indirectly affect SMEs by the contractual clauses in the chain.
- The **competences** of the supervisory authorities need **to be clarified**. Indeed according to article 17.1 they have “to supervise compliance with the obligations laid down in national provisions adopted pursuant to Articles 6 to 11 and Article 15(1) and (2).” So not the obligations on corporate governance of article 25 and 26. However Article 18.1 states that the powers are “related to compliance with the obligations set out in this Directive”, so also 25 and 26.

Art 18 Powers of the supervisory authorities

- SMEUnited regrets that this article only sets out the supervision and enforcement powers, while the element of advice and assisting in the learning process is absent. This is also especially relevant for the possible co-operation within the chain between large and smaller companies. We insist on introducing the principle of “**advice instead of sanctions**”. This means also that when a company complies with the remedial measures imposed by a supervisory authority, there should not be any administrative sanctions and no civil liability.

¹⁶ Page 17.

Art 18.1

- In our view the resources to carry out the supervisory task will be quite substantive, while the Explanatory Memorandum¹⁷ states that “this Directive does not entail unnecessary costs”.

Art 18.3

- According to this article “*Inspections shall be conducted in compliance with the national law of the Member State*”. In our view this is again a high **risk** to the **level playing field**.

Art 19 Substantiated concerns

Art 19.5

- In our view Article 19.5 is a duplication of 18.7, but more elaborated, and only focused on complainants. Art 18.7 and 19.5 should be brought in line with each other.
- Consideration should also be given to safeguarding the interests of the companies concerned and, in the event of an unjustified accusation, to providing for a corresponding claim for damages in favour of the company - if necessary, also on a lump-sum basis.
- Art.19 on substantiated concerns and the definition of art. 3.n on stakeholders should be brought in line so that stakeholders must present a substantiated concern in order to be heard.

Art 20 Sanctions

Article 18.4 and 18.5 b refer to the administrative sanctions of Article 20. The title should be adapted accordingly.

SMEUnited notes that the element of sanctions in this Directive will only apply to the companies mentioned in article 2, Not to SMEs. However, in the chain, sanctions may have an indirect effect on SMEs.

Proposed amendment: Change title in “**Administrative** sanctions”

Art 20.1

SMEUnited fully supports the approach of the European Commission to secure the respect of the obligations by the implementation of sanctions.

Administrative sanctions are unfortunately necessary towards companies failing to comply with the due diligence requirements set out in the directive. However, when implementing the

¹⁷ Ibidem

directive at national level, care must be taken to ensure that the penalties are proportionate and not unreasonably high.

Article 20.1 states that the rules on sanctions are determined on the national level. This is unacceptable with a view to the level playing field. This approach risks indeed to create distortions between the different legal systems. It is important to ensure that certain Member States do not adopt a lower level of sanctions in order to attract European companies to their territories as this could create significant distortions of competition in the single market.

The directive should clarify that the sanctions are directed exclusively against the company and not against the management. For the imposition of fines, and depending on their size, it is necessary that the substantive norms that could be violated are precisely defined (necessity of clarity and definiteness).

In France, the Conseil Constitutionnel has declared unconstitutional the provisions of the French law (“devoir de vigilance”) providing for fines because the sanctions could be based on the violation of broad and vague terms (cf. Décision n° 2017-750 DC du 23 mars 2017).¹⁸

If sanctions are imposed on companies, consideration should be given to dedicating the funds to assist the companies in implementing the requirements with these funds or to assist with measures (e.g., environmental protection) that the intent of the draft is to promote.

Art 20.3

According to this article pecuniary sanctions shall be based on the company’s turnover. We wonder why this criterion should be mandatory, as any motivation is missing in the explanatory memorandum.

Furthermore, we fear that financial penalties will be passed on indirectly throughout the value chain. SMEs are concerned about the possibility of retaliation by their sanctioned partners in the event that they are unable to provide the information requested.

Art. 21 European Network of Supervisory Authorities

Art 21.

- The network should facilitate and ensure the coordination and alignment of regulatory, investigative, sanctioning and supervisory practices of the supervisory authorities as well as the sharing of the information among them. We have our doubts if this will be sufficiently effective to safeguard a level playing field.
- The application of the “once-only principle” is required in order to reduce administrative burdens. The European Supervisory Authorities must design their information exchange

¹⁸ [Commentaire de la décision n° 2017-750 DC du 23 mars 2017 - Loi relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre \(conseil-constitutionnel.fr\)](#)

in such a way that companies do not have to repeatedly provide the relevant information to different authorities.

Art. 22 Civil liability

According to this article civil liability is only established for companies, there is no personal liability for directors. Civil liability is limited to failing to comply with Articles 7 and 8 (prevention and bringing impact to an end). Furthermore it is limited to the companies mentioned in article 2.

The article differentiates only marginally between liability for own acts of the company and liability for acts of others in the value chain. This is a substantial diversion from the OECD Guidelines where this is an essential difference.

Companies are not liable if they have sought contractual assurances, have in place a prevention action plan, and apply contractual cascading, and if compliance has been verified. As the fulfilment of the condition of seeking has important consequences, it is essential that the obligation of means to seek should be very clearly defined. The model contract clauses of Art. 12 are thus of great importance.

We believe that the provision regarding civil liability (Article 22) should be deleted or should be substantially amended. It is unclear how the responsibility would be shared between different parties in the value chain. It is therefore possible that liability will be cumulated to companies whose national law the victims consider to be the most favorable to them. The provision is also contrary to the general principles of civil law that liability of damages requires adequate causation, and that the entity causing the damage is liable for compensating the damages.

The proposed draft is not suitable for enabling companies to make legally secure decisions. Vague formulations and unclear definitions do not reach the level of adequate legislation.

Liability with regard to indirect suppliers must be excluded, as this would entail liability for facts of others. It should be made clear that the party liable to pay compensation must also be at fault for causing the damage.

Companies should not be held liable for damage in their supply chain if they did not directly cause it, could not reasonably have known about it, or if they took the appropriate due diligence measures to prevent it. Legal requirements should not inadvertently lead to situations where companies are held liable precisely because they have taken reasonable due diligence measures.

Furthermore, it is problematic that the draft does not contain any rules on the burden of proof. Since proof will be difficult to provide in many cases, it will play a major role who must bear the burden of proof. Especially in the application of the directive, there will probably be a plethora

of special cases such as alternative or overriding causality. Since the liability provisions are not harmonised, this can lead to distortion of competition. A general shift of the burden of proof to the companies is strictly rejected.

There is a need to clarify how the liability rules relate to claims between the various private parties in the chain, in particular joint and several liability and recourse claims along the supply chain.

The provisions for pursuing claims must be consistent with the international legal framework. It should be noted that both the place of jurisdiction and the country where the company is based, must be applicable. Article 22(5) is legally impracticable: mandatory application of the provisions of the Directive can only be provided for in national law. The application of the provisions when the law of another state is applicable cannot be mandated by a nation state.

In addition to any civil law consequences, a lawsuit, given the expected media attention, would be damaging to a company's reputation and could lead to a preliminary conviction - regardless of the outcome of the proceedings.

Art 24: Public support

According to this article companies applying for public support must **certify** that no sanctions have been imposed on them for a failure to comply with this directive. SMEUnited is of the opinion that without further qualification this seems to be a disproportionate measure. It is indeed a disproportionate effort for companies to actively prove that they are compliant. The respective funding body should verify this itself if necessary or specify it in the funding guidelines.

Art 25 Directors' duty of care

Although this article does not apply to SMEs, we have serious concerns about it. It is in our view very challenging to establish mandatory and detailed regulation at EU level to determine the general responsibilities of a company's management and "directors' duty of care". The Member States' regulatory systems differ significantly to make this possible. Any effort to harmonise the regulations may lead to significant changes in company law structures and also to legal uncertainty.

The obligations of company directors formulated in this article are much too broad. Long-term estimates of the effects of actions are likely to founder on the impossibility of valid forecasts. The Commission proposal leaves open what duty of care and other obligations of the company's management would mean for example in relation to the interests of the company and its stakeholders. The proposal also does not specify in sufficient detail which sustainability issues need to be taken into account and what their relationship may be to the general duty of care imposed by national laws and regulation.

The proposal could lead to a breakdown in the symmetry between risk and control. The article does also not give an answer to the question which stakeholder interest and how the management should promote in situations where all stakeholder interests cannot be served simultaneously.

The obligation to act in the best interests of the company is standing law. We consider that the provision regarding directors' duty of care (Article 25) should not be included in the directive. Interference in national corporate governance models is neither necessary nor proportionate or suitable to achieve the goal of promoting corporate sustainability.

The provision is unclear and unnecessary for achieving the regulatory objectives. The objectives set out in the regulation of directors' duty of care can be achieved more effectively and appropriately through specific legislation than by interfering with fundamental company law structures.

Proposed amendment: to delete Article 25.

Art 29 Review

The title of this article is confusing as nothing is said in it about a "Review", but only about an 'evaluation'. A 7 year evaluation term is in our view far too long for such an impactful legislation. This is especially so since the Regulatory Scrutiny Board has twice given a clearly negative opinion and has not been consulted for the third version. The evaluation period should therefore be no longer than 2 years after the transposition in national legislation.

Any evaluation must be designed to be without prejudice to results. The present formulation only allows an extension of the scope of application from the outset and thus precludes a comprehensive review of the Directive's effectiveness. The evaluation report should also assess the impact on SMEs and the evaluation of the support measures and tools and take into account the burdensome nature of these obligations for SMEs and the unequal access to resources compared to large companies.

Proposed amendment: "No later than ~~7~~ **2 years after its transposition in national legislation...**"

Proposed amendment:

(a) whether the thresholds regarding the number of employees and net turnover laid down in Article 2(1) need to be ~~lowered~~ **changed**;

~~(d) whether Articles 4 to 14 should be extended to adverse climate impacts.~~

(e) the impact on SMEs

(f) The availability of supporting tools

- (g) The guidelines
- (h) The model contractual clauses
- (i) Other accompanying measures.

Art 30 Transposition

When the regulations come into force at national level, a practicable timetable is required. If the final version of the Directive would remain a minimum harmonisation providing the member states with a considerable amount of leeway, it is not practicable for all the provisions to enter into force at the same time as they are transposed into national law. Companies need sufficient lead time to implement these due diligence processes. The Directive should provide for a reasonable transposition period of at least 3 years.

Proposed amendment: “Member States shall adopt and publish by **2 3 years from the entry into force...**”

... They shall apply those provisions as follows:

- (a) from... [O] to insert: **42** years from the entry into force of this Directive] as regards companies referred to in Article 2(1), point (a), and Article 2(2), point (a);
- (b) from ... [O] to insert: **64** years from the entry into force of this Directive] as regards companies referred to in Article 2(1), point (b), and Article 2(2), point (b).

Brussels, 26st September 2022

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