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GOVERNMENT SUBMISSION 23 MAY 2022

PROPOSAL FOR CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE PUBLIC CONSULTATION RESPONSE

E3G welcomes the Commission’s proposal for the Corporate Sustainability Due Diligence Directive (CSDDD) as an important step to incorporate sustainability considerations in corporate due diligence practices and directors’ accountability to stakeholders. Although the proposed Directive sets the direction for large EU companies’ approaches to due diligence, it can be strengthened to ensure a positive impact on society and the environment. E3G proposes several amendments to the proposal in this consultation response.

E3G believes that improvements to the following aspects of the proposal should be considered:

- I. **The scope of the Directive needs to be broader** to align with other corporate legislation at the EU level (like the CSRD) and to ensure companies in high-risk sectors are adequately covered.
- II. **Provisions for companies’ transition planning need to be strengthened** to better address climate-related obligations and accountability linked to director duties and overall due diligence.
- III. **Corporate variable remuneration policies** need to be explicitly linked to the company’s long-term sustainability goals and transition planning to ensure corporate accountability for adverse impact.
- IV. **Human rights due diligence requirements should be strengthened** to consider a broader range of adverse impacts for vulnerable communities, including climate adverse impacts, across the whole supply chain.



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I. Broaden the Directive's scope

We propose **amending Article 2** to:

1. **Expand the scope of the Directive to companies with over 250 employees:**
 - > The current scope of the Commission's proposal, which targets companies with 500 or more full-time employees, represents only 1% of Europe's businesses, i.e., around 13,000 EU companies. Yet, a company's exposure to sustainability risks and its impact on people and the environment are not limited to its size. By excluding the vast majority of companies, the CSDDD as it currently stands risks severely limiting the ability of companies and investors to properly assess and manage material risks.
 - > Given the interlinkages between the CSDDD and the CSRD (Corporate Sustainability Reporting Directive) proposal, the scope of the two legislations should be aligned and cover companies with over 250 employees, as is currently suggested under the CSRD.

2. **Expand the scope of the Directive to include SMEs in identified high-risk and high-impact sectors:**
 - > While we acknowledge the need for a proportional approach to corporate responsibility requirements that consider the extent of the company's impacts and its ability to mitigate these impacts, it is important to acknowledge that all businesses operating in the EU bear responsibility for human rights and the environment irrespective of their size, not just listed SMEs. SMEs with more than 50 employees in identified high-risk and high-impact sectors should therefore be covered in the Directive. This would not only provide more legal certainty but would also foster a shared responsibility for the global value chains and their adverse impacts.
 - > Following the CSRD inclusion of listed SMEs, the scope of companies conducting due diligence should also be aligned in the CSDDD to ensure coherence across different corporate governance legislation.



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II. Strengthen provisions for transition planning

We welcome the explicit inclusion of Article 15 on combating climate change. Specifically, the clear requirement for compatibility of companies' business models and transition to a sustainable economy with the limiting of global warming to 1.5 °C in line with the Paris Agreement is a much-welcomed approach.

To ensure that businesses operating in the EU are better placed to assess and address climate-related risks, we suggest **strengthening the wording of Article 15 to:**

- 1. Clearly link the provisions for transition planning to Article 25 and Article 26 addressing directors' duty of care and due diligence oversight.**
 - > In this way mandatory and well-drafted transition plans will help inform and shape the strategy of a competitive company in the future. This is important for the strategy and transition of European businesses and goes beyond reporting obligations. Moreover, the right provisions need to be in place to avoid a box-ticking approach and ensure meaningful and practical transition planning.
- 2. Link it with the Corporate Sustainability Reporting Directive (CSRD) materiality assessment.**
 - > **Companies' transition plans should be informed by a double materiality assessment.** Such an approach recognizes businesses' adverse impacts on people and the environment and would be consistent with the corporate reporting requirements under CSRD, and Europe's direction of travel to address climate risks. Member States should also ensure that these provisions identified in this Article 15 are duly overseen by directors as well as the due diligence process as spelled out in Article 26.
- 3. Include key principles for ambitious and well-designed transition plans for companies:**
 - > For the transition plans to be ambitious and comparable, and for building the ambitious EU transition finance framework outlined in the Renewed Sustainable Finance Strategy of 2021, it is important to outline the main overarching principles of such transition plans. Beyond observing the EU "do no significant harm" principle, and for the purpose of aligning with all environmental objectives as set out in the Taxonomy Regulation, E3G suggests adding the following principles to the Directive:



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- a. Transition plans should be **aligned with an economy-wide transition to climate neutrality by 2050** as stipulated in the EU Climate Law, and should be **consistent with limiting global warming to 1.5 °C in line with the Paris Agreement**.
 - b. The focus should be placed on **concrete actions and targets aligned with both near- medium- and long-term objectives**. This needs to be backed up by clear governance mechanisms and should be linked to the assurance provisions of the CSRD.
 - c. **Periodic reporting against those targets and a credible verification process** of the progress towards the companies' set objectives should be enabled in a transparent manner.

Finally, while requirements relating to human rights and environmental impact are incorporated in the due diligence aspects of the proposal, it is important to ensure that climate-related risks and impacts are also properly introduced in the due diligence process and companies' corporate accountability. We therefore suggest that **the proposal legally define and incorporate the concept of "climate due diligence"**.

III. Directors' accountability and variable remuneration

The provisions for directors' duties included in the CSDDD proposal are limited compared to the Commission's initial impact assessment. To ensure directors' accountability to stakeholders, **these aspects need to be strengthened and spelled out in more detail, especially in Articles 15 paragraph 3, 25 and 26**. In particular, climate-related obligations through transition planning and accountability for companies' operations and performance beyond returns should be strengthened.

We therefore suggest reinforcing the wording for Article 15, paragraph 3 to:



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1. Make Directors' remuneration requirements mandatory

- > We welcome the consideration of directors' remuneration in Article 15 paragraph 3 of the Commission's proposal. However, the **proposed voluntary nature of this provision risks having only a limited impact in practice** stripped of the more tangible forward-looking commitments and efforts needed by European businesses and their boards of directors. The text of Article 15, paragraph 3 should be improved to **include a mandatory requirement to tie executives' remuneration to the company's sustainability goals.**

2. Link Director's remuneration to achieving specific targets in companies' transition plans

- > Specific requirements for linking the board of directors' remunerations to achieving the climate transition targets in Article 15 are currently missing from the proposal and are considered only on a voluntary basis. Directors are tasked to strengthen the long-term value-creation of the company. However, the compensation strategies and the business ecosystem in which companies operate (market and regulatory mechanisms, international, EU and national company law, corporate shareholders) are still linked to short-term value maximization, which has proven to be too narrow and potentially detrimental to the long-term strategy of a business. **The suggested amendment would support businesses to consider and invest in long term value creation.**
- > Therefore, **EU companies should be required to link the variable compensation of directors with the achievement of sustainability targets in their transition plans.** This would represent an important first step towards long-term value creation, for a future-proof business strategy that ensures its own continuity and financial stability.

3. Include a provision for broader sustainability and social factors in variable remuneration

- > By focusing only on climate change mitigation objectives as per Article 15, the remuneration requirements fail to consider directors' obligations and accountability for other societal and environmental impacts the company might have. Directors' variable remuneration should therefore consider broader sustainability factors beyond climate change mitigation targets.



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IV. Human rights due diligence requirements

The provisions for human rights due diligence in the Directive should be improved to:

1. Link climate and environmental vulnerabilities to human rights

- > As the manifestations of climate change become more severe and disproportionately affect different communities, it is important to recognize the linkages between human rights and adverse climate impacts. Therefore, we suggest that **climate-related and environmental vulnerabilities are explicitly linked to human rights due diligence requirements and the necessary safeguards are put in place to respect these rights.**

2. Ensure human rights are considered across the whole supply chain

- > By introducing the concept of “established business relations”, the CSDDD risks leaving out the negative human rights and environmental impacts on marginalized groups at the beginning of the EU supply chains. These groups are often part of the informal sector, with limited pathways towards enabling their labour rights, which is why their representation in any potential partnership/business arrangement should be guaranteed. This would be in keeping with the Aarhus Convention and ILO guidelines on achieving decent work in global supply chains.
- > It is furthermore important to note that an untested legal concept can have unintended consequences for social goals: as a result of its novelty, the concept might incentivize the maintaining of, or a shift to, short-term business relationships, where it is easier to identify the (usually lower) impacts but at the expense of building long-term solidarity and trust with marginalised groups. At the same time, persisting with established business relations – without broader participation and representation – risks emboldening incumbents with vested interests, potentially fuelling corruption and compromising on human rights standards.

3. Include identification and mitigation of risks related to vulnerabilities

- > The proposal does not currently include the concept of “prioritization of risks” based on the severity and likelihood of the adverse impact, which is



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mentioned in the OECD Due Diligence Guidance for Responsible Conduct. This represents another incentive to ignore impacts at other points of the supply and subcontracting chain. Therefore, **we recommend that corporates' risk management procedures include: identification, mitigation, and remedying of risks; voluntary controls to ensure these are upheld; and voluntary disclosure of efforts to protect and support vulnerable workers across supply chains.**

The Corporate Sustainability Due Diligence Directive is a crucial piece of EU legislation, which has the potential to transform how businesses operate in a more socially and environmentally responsible way. We believe the amendments suggested above would improve the Commission's proposal in achieving its intended impact and would support companies in their climate transition and social and environmental accountability.

About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action. More information is available at www.e3g.org

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