CORPORATE SUSTAINABILITY DUE DILIGENCE

- THE NEW MANTRA AND ITS FALLACIES -

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Survey

Sustainability has become the new mantra of the 21st century. On 23 February 2022, the European Commission decided to add its voice to this new mantra, and even tried to take the lead worldwide, by releasing a *Proposal for a Directive on Corporate Sustainability Due Diligence* (hereinafter abbreviated Proposal, CSDDD or CS3D).[1]

[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).

1. BACKGROUND

1.1. The Origins

I. The remote origins of the Proposal are to be found in the "Action Plan on Sustainable Finance" (2018)[2] and "European Green Deal" (2019)[3], where the European Commission proclaimed that European companies should become a sort of global leaders concerning the sustainability defy: in its own words, "sustainability should be further embedded into the corporate framework, as many companies still focus too much on short-term financial performance compared to their long-term development and sustainability aspects".[4]

II. To address this challenge, the initiative of the European Commission was based in two commissioned studies on sustainable corporate governance: the "Study on Due Diligence Requirements Through the Supply Chain" undertaken by the British Institute of International Comparative Law on January 2020 (the BIICL Report)[5] and the "Study on Directors' Duties and Sustainable Corporate Governance", undertaken by Ernst and Young on July 2020 (the EY Report).[6]

III. The gestation of this Proposal of Directive has been quite long and bumpy, made of a series of advances and setbacks spanning over more than 3 years. This includes the "European Commission Consultation Document Proposal for an Initiative on Sustainable Corporate Governance" (26 October 2020)[7], the "European Parliament Resolution with Recommendations to the Commission on Corporate Due diligence and Corporate Accountability" (10 March 2021)[8], and, particularly important, the two negative opinions

[2] "Action Plan: Financing Sustainable Growth" (COM/2018/097 final).
[3] "The European Green Deal" (COM/2019/640 final).
[4] "The European Green Deal", p. 17 (COM/2019/640 final).
[5] European Commission, Directorate-General for Justice and Consumers, *Study on Due Diligence Requirements Through the Supply Chain – Final Report*, Publications Office, 2020 (available at https://data.europa.eu/doi/10.2838/39830).
[6] European Commission, Directorate-General for Justice and Consumers, *Study on Directors' Duties and Sustainable Corporate governance – Final Report*, Publications Office, 2020 (available at https://data.europa.eu/doi/10.2838/472901).
[7] Available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance_en.
[8] Available at https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52021IP0073.

issued by the Regulatory Scrutiny Board (RSB) on "Inception Impact Assessment", which temporarily halted the initiative (April 2021 and November 2021).[9]

1.2. Further Developments

I. After the publication of the Proposal in 23 February 2022, there were two major developments: on November 23, 2022, the EU Council adopted its negotiating position ("General Approach") on the Proposal[10]; an on June 1, 2023, the European Parliament adopted amendments to Proposal.[11]

II. Now that the Proposal has been adopted, negotiations with the EU Council and member states will begin. While member states previously reached a consensus on the Directive in EU Council in its General Approach of November 2022, certain issues are likely to be heavily discussed. Furthermore, the European Parliament and the EU Council must agree on a position before engaging in a final round of negotiations with the European Commission to finalize the Directive.

1.3. The Academic and Business Debate

I. The Proposal for a Directive on Corporate Sustainability Due Diligence (CSDDD) sparked an *extensive debate* both in Europe and the US, at academic, business and political forum, with tens or even hundreds of studies being published from 2020 to the present date.

II. In particular, it raised a strong opposition and criticism of scholars, both in Europe – namely, several scholars of the European Company Law Experts (ECLE) and the European Corporate Governance Institute (ECGI) –[12] and in the United States – namely,

[9] SEC(2022)95. On those negative opinions, see also the Proposal (pp. 20f.).
[10] Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 – General Approach (2022/0051(COD)) (available at https://data.consilium.europa.eu/doc/document/ST-15024-2022-REV-1/en/pdf).
[11] Amendments adopted by the European Parliament on 1 June 2023 on the 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)0071 – C9-0050/2022 – 2022/0051(COD) (available at https://www.europarl.europa.eu/doceo/document/TA-9-2023-0209_EN.html).
[12] EUROPEAN CORPORATE GOVERNANCE INSTITUTE (2021), *The European Parliament's Draft Directive on Corporate Due Diligence and Corporate Accountability* (available at

a group of professors of the Harvard Law School (HLS) and the Harvard Business School (HBS) –[13], especially concerning the provisions of the Proposal on sustainable corporate governance.

1.4. Other International and National Endeavours

I. In spite of the pivotal significance in a European and even worldwide context, the Proposal was preceded by a number of soft law and even hard law initiatives on sustainable corporate governance and the protection of human rights and environment.

II. At an *international level*, one should mention the "UN Guiding Principles on Business and Human Rights" (2011)[14], as well as the "OECD Guidelines on Multinational Enterprises" (2011) and the "OECD Due Diligence Guidance for Responsible Business Conduct" (2018)[15]. In fact, the EU Directive Proposal was largely inspired by the set of international standards on responsible business conduct contained in those two Guidelines. As expressly acknowledged in the Proposal, "the behaviour of companies across all sectors of the economy is key to succeed in the Union's transition to a climate-neutral and green economy in line with the European Green Deal and in delivering on the

https://www.ecgi.global/publications/news/commentary-the-european-parliaments-draft-directive-on-corporate-due-diligence); EUROPEAN COMPANY LAW EXPERTS (2022), *EC Corporate Governance Initiative Series: Comment by the European Company Law Experts Group on the European Commission's Consultation Document 'Proposal for an Initiative on Sustainable Corporate Governance* (available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2020/12/ec-corporate-governance-initiative-series-comment-european-company); NORDIC AND BALTIC COMPANY LAW SCHOLARS (2022), *Response to the Proposal for a Directive on Corporate Sustainability Due Diligence by Nordic and Baltic Company Law Scholars*, Nordic & European Company Law Working Paper No. 22-01 (available at https://ssrn.com/abstract=4139249).

[13] HARVARD LAW SCHOOL (2021), *Law and Business Professors' Submission to the EU on EY's Study on Directors' Duties and Sustainable Corporate Governance – Response to the European Commission's Call for Feedback on its Sustainable Corporate Governance Initiative* (available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/F594640_en); ROE, Mark J./ SPAMANN, Holger/ FRIED, Jesse M./ WANG, Charles C. (2022), *The European Commission's Sustainable Corporate Governance Report: A Critique*, Harvard Public Law Working Paper No. 20-30 (available at http://dx.doi.org/10.2139/ssrn.3711652).

[14] UNITED NATIONS, *Guiding Principles on Business and Human Rights*, 2011, available at https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf.

[15] ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, *OECD Guidelines for Multinational Enterprises* (2011 updated), with set of recommendations on responsible business conduct, available at https://doi.org/10.1787/9789264115415-en, and the specific *OECD Due Diligence Guidance for Responsible Business Conduct* (2018), available at https://mneguidelines.oecd.org/mneguidelines/.

UN Sustainable Development Goals, including on its human rights- and environment-related objectives".[16]

III. At a *national level*, there has been also a gradual rise of legislative initiatives on sustainable corporate governance. As the aforementioned international tools of voluntary nature appeared increasingly soft and ineffective, some countries decided to enact their first mandatory hard laws on human rights and environmental corporate due diligence[17]. The regulatory landscape was first marked by the emergence of laws aimed at encouraging companies to exercise human rights due diligence through transparency obligations: this was the case, for instance, with the "California Transparency in Supply Chain Act" (2010), the "UK Modern Slavery Act" (2015) or the "Australian Modern Slavery Act" (2018). Later on, some other countries went further and beyond simple transparency obligations, by imposing on some companies genuine due diligence obligations relating to human rights protection and sometimes also environmental protection.

IV. Three major examples include: the French *"Duty of Vigilance Law"* (2017), which requires large French companies to establish, implement and disclose a vigilance plan setting out due diligence measures taken in relation to human rights and environmental impacts of their operation[18]; the Dutch *"Child Labour Due Diligence Act"* (2019) which requires companies that supply goods or services to Dutch end-users to exercise human rights due diligence in relation to child labour[19]; and the German *"Supply Chain Due Diligence Act"* (2021) which imposes on large German companies a duty to identify and

[16] *Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence*, p. 1 (COM(2022) 71 final).

[17] For a general overview, see EUROPEAN COALITION FOR CORPORATE JUSTICE (2022), *Map: Corporate Accountability Legislative Progress in Europe*, available at https://corporatejustice.org/wp-content/uploads/2022/01/ECCJ-mHREDD-map-January-2022.pdf.

[18] «Loi 2017-399, du 27 mars 2017, rélative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre». On this French law, *see* SAVOUREY, Elsa/ BRABANT, Stéphane (2021), *The French Law on the Duty of Vigilance: Theoretical and Practical Challenges Since its Adoption*, in: 6 (1) "Business and Human Rights Journal", pp. 141-152 (available at https://doi.org/10.1017/bhj.2020.30); SCHILLER, Sophie (2019), *Le Devoir de Vigilance,* LexisNexis, Paris.

[19] «Wet van 24 oktober 2019 zorgplicht kinderarbeid». On this Dutch law, *see* ENNEKING, Liesbeth (2019), *Putting the Dutch Child Labour Due Diligence Act into Perspective. An Assessment of the CLDD Act's Legal and Policy Relevance in the Netherlands and Beyond*, in: 12 "Erasmus Law Review" (2019), pp. 20-36 (available at https://www.elevenjournals.com/tijdschrift/ELR/2019/4/ELR-D-21-00013.pdf).

account for their impact on human rights and even environment (such as forced and child labour, forced evictions, oil pollution and land grabbing).[20]

1.5. Other EU Initiatives on Corporate Sustainability Issues

I. Sustainability has long been at the heart of the European project to contribute to a sustainable transition of economies, societies, and enterprises. This commitment is substantiated in a cluster of other EU initiatives related to corporate sustainability. Here are a few examples:

II. The *Non-Financial Reporting Directive of 2014 (NFRD)*[21], which is a European Directive that requires certain companies to provide and disclose a separate non-financial document along with their annual reports. This document, sometimes known as a "sustainability report", concerns information on environmental, social and human rights related risks, impacts, measures (including due diligence) and policies.

III. The *Sustainable Finance Disclosure Regulation of 2019 (SFDR)*[22], which is a European Regulation that requires financial market participants (namely, investment funds and portfolio managers) and financial advisers to provide information on a wide range of environmental, social & governance (ESG) metrics at both entity and product-level (including a statement on their due diligence policies with respect to principal adverse impacts of their investment decisions on sustainability factors, on a comply or explain basis). The aim is to enhance transparency regarding more sustainable businesses, products or services, by offering investors a more comparable approach to understanding sustainability.

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[20] «Gesetz über die unternehmerischen Sorgfaltspflichten in Lieferketten of 16 July 2021». On this German law, *see* FLEISCHER, Holger/ MANKOWSKI, Peter (2023), *Lieferkettensorgfaltspflichtengesetz*: *LkSG*, C.H.Beck, München. There are also other similar initiatives in preparation on other countries (e.g., Belgium, Luxembourg).

[21] Directive 2014/95/EU amending Directive 2013/34/EU (accounting directive), as regards disclosure of non-financial and diversity information by certain large undertakings and groups (OJ L 330, 15.11.2014, p. 1-9).

[22] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1-16).

IV. The *Taxonomy Regulation of 2020 (TR)*[23], which is a European Regulation that establishes a classification system (taxonomy) or a common definition of economic activities deemed environmentally sustainable. Its goal is to facilitate decisions on investment, enhance market transparency, and address greenwashing by providing a categorisation of environmentally sustainable investments in economic activities that also meet a minimum social safeguard.

V. Lastly, the *Corporate Sustainability Reporting Directive of 2022 (CSRD)*[24] is a European Directive that mandates all large companies and all listed companies (except listed micro-enterprises) to disclose information on the risks and opportunities arising from social and environmental issues, as well as on the impact of their activities on people and the environment. This Directive complemented the NFRD of 2014, by expanding the scope of companies covered and the rules concerning the social and environmental information. The aim is to provide investors and other stakeholders with access to the information concerning the impact of companies on people and the environment and to assess the financial risks and opportunities arising from climate change and other sustainability issues.

2. SCOPE

I. The Proposal was titled a Directive on *"corporate sustainability"*. But what does "*sustainability*" exactly mean? And which "*corporations*" are specifically covered? In other words: what is the precise scope of the CSDD Proposal?

2.1. Material Scope: What is Sustainability?

I. Sustainability is a word of many meanings. In the context of the Proposal, however, it holds a very specific meaning: it means the *compliance of companies with the standards*

[23] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088 (OJ L 198, 22.6.2020, p. 13-43).
[24] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

laid down in a cluster of international treaties relating to the protection of human rights and the protection of the environment.

As a matter of fact, the Proposal establishes rules on obligations and liabilities for companies regarding actual and potential human rights and environmental adverse impacts, with respect to their own operations, as well as of its subsidiaries and value chain operations (Article 1): according to it, an adverse human right or environmental impact means a negative impact resulting from the violation of any standards or prohibitions outlined in international treaties and conventions on human rights and environment protection, as listed in its Annex I and II (Article 3(b) and (c)).

The material scope of these new sustainability duties and liabilities presents some significant *shortcomings*, which may be the source of legal uncertainty for companies. This is due for several reasons.

II. *A) Wide Scope*. First of all, the relevant standards are *extremely numerous*. Altogether, there are more than 60 international treaties/conventions/guidelines: the Annex of the Proposal mentions 21 human rights treaties (along with an additional 22 conventions, often without specifying their relevant applicable provisions) as well as 18 treaties on environmental protection[25]. Moreover, the standards applicable are not exhaustive, since any violation of a prohibition or right not explicitly listed in these international instruments also consider relevant if it directly impairs a legal interest protected by them (Recital 25, Annex Part I-1, point 21).[26]

III. *B) Undetermined Standards*. Secondly, the relevant standards are often quite *vague and open-ended*, making it difficult to define their precise content for companies and other recipients of the Directive. For instance, consider the right to a "decent living", a "fair wage" or "equitable conditions of work" as provided for by the "International Covenant on Economic, Social and Cultural Rights (Article 7). This provision, applicable pursuant Annex I – Part I.7 of the Proposal, may have different interpretations in different

[25] This number is even higher in the amended version Proposal by the European Parliament of 1 June 2023 (*see* above 1.2), which includes some additional 12 international treaties and conventions.
[26] *See* also LITTENBERG, Michael/ ELLIOT, Samantha/ BOHN, Austin (2022)*, A Q&A on the European Commission's Proposed Corporate Sustainability Due Diligence Directive*, 1, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/05/qa-european-commissions-proposed-corporate-sustainability-due.

countries: it will certainly be complex for a company to assess the specific content of such a standard, in order to comply with its diligence duties and to avoid the associated liability, concerning its business partners located in various parts of the world as different as Europe, Asia or Africa.[27]

IV. *C) Public Law Nature.* Thirdly, the relevant standards are typically *public law standards*. By definition, international treaties aim to impose public obligations on the contracting States and were not designed to establish duties that are directly applicable and binding to private actors: these inter-state obligations are often formulated in general terms, and no concrete liability or consequences for the non-compliant State are usually associated with their breach. Consider, for instance, Article 15(1) of the Proposal, which requires large companies to adopt a corporate plan compatible with the limitation of global warming to a 1.5 degree benchmark in accordance with the Paris Agreement: as it shall be explained further on, such international benchmark is global in character, rendering difficult, if not impossible or meaningless, to derive from it direct duties for individual companies across all sectors and all geographic areas.[28]

V. *D) Neocolonialistic Bias*. Fourthly, the relevant standards are *exorbitant*. Given the extraterritorial scope of the Proposal[29], such standards may be applicable even in jurisdictions where the relevant underlying international instrument at hand was not ratified or recognised at all, inducing thus a sort of "exporting" of European values on human, social and industrial relations to non-European countries[30]. Consider, for example, the right to form and joint trade unions or the right to collective bargaining, which are laid down in international labour conventions (mentioned in Annex I – Part I-15 of the Proposal), which shall be also applicable to non-EU subsidiaries established in

[27] Also RECALDE CASTELLS, A. Juan (2022), *La Obligación de las Sociedades de Identificar, Reducir y Reparar los Efectos Adversos sobre el Medioambiente y los Derechos Humanos*, 28, in: 326 "Revista de Derecho Mercantil", 1-43.

[28] Also FERRARINI, Guido (2022), *Corporate Sustainability Due Diligence and the Shifting Balance Between Soft Law and Hard Law in the EU*, 1, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/corporate-sustainability-due-diligence-and-shifting-balance-between. On the duty on combating climate change, see below 3.4.

[29] *See* below 2.2 (III).

[30] On this sort of legal neocolonialism, see EUROPEAN COMPANY LAW EXPERTS (2021), *The European Parliament's Draft Directive on Corporate Due Diligence and Corporate Accountability* (available at h ttps://www.ecgi.global/publications/news/commentary-the-european-parliaments-draft-directive-on-corporate-due-diligence); speaking here of a "imperialistic element", *see* PIETRANCOSTA, Alain (2022), *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, 14, ECGI, Law Working Paper N° 639/2022.

countries with different labour law and practices (Articles 1(a) and 2(2)). Take the case of US Amazon, which labour practices may fail to strictly meet with those international law labour standards, as the United States of America did not ratify all the ILO conventions[31]: if such practices were deemed to deploy an adverse human rights impact in an Amazon's European subsidiary subjected to the CSDD, then that subsidiary would face sanctions and liability, which would ultimately affect the US parent.

VI. *E) Mutually Contradictory*. Finally, given their number and disparate nature, those standards *may conflict with each other*. In fact, human rights and environment are two different issues which do not necessarily stand together, reason why the Directive may give rise to contradictions and paradoxes in its own application whenever a certain corporate action, while having a positive human-social impact, deploys negative impacts on environment or vice-versa. Think, for instance, in the decision of an oil company to shut down a coal mine or an oil rig, which reduces the greenhouse gas emissions while at the same time leads to a massive loss of jobs for its workers.[32]

2.2. Personal Scope: What Companies Are Covered?

I. If the material scope of the Proposal is quite broad, its personal scope is no less ambitious: according to Article 2, the future Directive *shall apply both to companies formed within and outside the European Union*.

Whether a particular company is subject to its application would depend on certain thresholds on turnover, number of employees and economic sectors, as outlined in the Table below.

[31] In: https://www.uscib.org/docs/US_Ratification_of_ILO_Core_Conventions.pdf. On the extraterritorial application of human rights, see JANIG, Philipp (2022), *Extraterritorial Application of Human Rights*, in: Binder, C./ Nowak, M./ Hofbauer, A./ Janig, P. (eds), "Elgar Encyclopaedia of Human Rights", vol II., pp. 180-191, Edward Elgar Publishing, Cheltenham, available at https://ssrn.com/abstract=3906741.
[32] RICHTER, M. Stella/ PASSADOR, M. Lucia (2022), *Corporate Sustainability Due Diligence: Supernatural Superserious*, 10, available at https://ssrn.com/abstract=4293912 .

	EU Companies	Non-EU Companies
Large Companies	➢ 500 employees ➢ € 150M worldwide turnover	➢ € 150M turnover generated in the EU
High-Risk Sector Companies (e.g., extractive industry, textiles, etc.)	➢ 250 employees ➢ € 40M worldwide turnover (>50% in high-risk sector)	➢ € 40M turnover generated in the EU (> 50% of worldwide turnover in high-risk sector)
Estimated Total Number	13 000 companies	4 000 companies

Regarding *European companies* (that is, companies incorporated in a Member State), the Directive applies to large companies (companies with more than 500 employees and a net worldwide turnover of more than 150 million euros), but also to some smaller companies (with 250 employees and a turnover of 40 million) so long as 50% of that turnover was generated in high-risk sectors (for instance, extraction of mineral resources, such as coal, oil or gas). But the Directive shall also be applicable to *non-European companies*, that is, incorporated in third countries. In this case, the application follows similar thresholds, although with some differences: it relies only on the turnover criteria (disregarding the employee criteria) and it takes only into account the European net turnover of the company (and not its worldwide turnover).[33]

Again, there are also several reasons for concern in regard of the personal scope of the Proposal.

II. *A) Extraterritorial Reach*. The first concern is the *extraterritorial impact* of the Directive[34]. Companies are bound to sustainability due diligence regarding their own operations irrespective of where they are incorporated or located: an EU-based company

[33] Those categories and their defining criteria may differ in the final version of the Directive if the amendments proposed by the European Parliament in past June are accepted by the Council during the next negotiation round (*see* above 1.2).

[34] ENRIQUES, Luca (2022), *The Extraterritorial Impact of the Proposed EU Directive on Corporate Sustainability Due Diligence: Why Corporate America Should Pay Attention*, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/extraterritorial-impact-proposed-eu-directive-corporate.

must monitor adverse human rights and environmental impacts in all its foreign subsidiaries just as a non-European based company must exercise the same regarding its European subsidiaries and chain partners. Take, for instance, the case of US multinational companies and groups, which may be affected by the scope of the Directive either directly or indirectly. To start with, any US individual company with a significant business in the European market (that is, a turnover generated in Europe exceeding 150 million) will be directly subject to Directive: this means that it must comply with its rules and obligation and exposed to its sanctions and liabilities, including in relation to its subsidiaries and business partners located worldwide. But this is also likely to happen indirectly in case that the US company is the parent of an European company covered by the Directive (e.g., the American parent Amazon controls the European Amazon's CSDD subsidiary): any action of the subsidiary contrary to the relevant international standards might reverberate upstream, because if the subsidiary fails to comply with its diligence duties and faces the inherent administrative and civil sanctions, the costs and losses resulting therefrom would be ultimately consolidated by the US parent.[35]

III. *B) Enterprise Reach*. Secondly, it must be highlighted the *enormous reach* of the Directive in the enterprise arena. While the Commission simplistically estimates that it will apply only to large companies representing 1% of the corporate arena[36] and boasts the exclusion of SME (representing the other 99%)[37], it is most likely that the Directive will reverberate across a greater number of business enterprises, especially small and medium-sized enterprises (SMEs). As it shall be explained further in detail, companies are bound to exercise its due diligence on adverse human rights and environmental impacts across their entire value chain, which may include hundreds or even thousands of other entities, mostly SMEs, which are operative either upstream or downstream in that

[35] There are other examples of the consequences of this enlarged scope of the Directive regarding foreign companies and groups. For instance, if a US company is a subsidiary of a European company covered by the Directive (e.g., the American branch of a large European-based telecommunications group) or simply a business partner within its value chain (e.g., an American manufacturer of auto component of the Rust Belt that sells products to a UE company car maker).

[36] According to Commission's estimation, the Directive will apply to about 13.000 European companies and 4.000 non-European companies, representing just 1% of the total number of companies operating in the European Union market (*see* "Explanatory Memorandum of the Proposal", p. 16).

[37] *See* "Explanatory Memorandum" of the Proposal (p. 14): "As regards the "personal scope" of the due diligence obligations (i.e. which business categories are covered), small and medium sized enterprises (SMEs) that include micro companies and overall account for around 99 % of all companies in the Union, are excluded from the due diligence duty".

company's supply chain[38]. The Directive will thus have a strong impact on SME, by imposing them significant burdens and costs directly or indirectly: this shall include compiling and gathering data on adverse impacts of their own operations to be transmitted to those companies, putting in place due diligence measures similar to those of larger companies (for example, compliance with the code of conduct of the company: cf. Articles 5(1)(c), 7(1)(d), 7(3) and 7(4)), concluding contractual assurances (Article 12), and so on.[39]

IV. *C)* "*Corporate" Duties?.* Thirdly, the Proposal adopts a rather *broad notion of company.* While formally aiming at the sustainability of companies, the Directive resorts to an overarching, excessive or improper concept of company which encompasses, in fact, most types of legal entities (Article 3). It applies not only to all relevant forms of companies (whether public and private companies, corporations and partnerships)[40] but also to an extensive list of 19 financial undertakings, regardless of its form: this includes credit institutions, alternative investment fund managers, pension funds, insurance undertakings, central counterparties, payment institutions, crowdfunding services providers and even crypto-asset service providers, amongst many others. Although reasonable and feasible in some cases, it is hard to imagine how some of the financial entities listed can even qualify to exercise due diligence duties in the relevant matters or

[38] The elimination of certain criteria (namely, the high-risk economic sector) and reduction of some of relevant thresholds (namely, by applying to companies with 250 employees and a turnover of 40 million), introduced in the amended version of the Proposal of June of 2023 (*see* above 1.3.), is likely to reinforce this trait even more.

[39] On this negative impact of the Directive on SME, *see* DOMÍNGUEZ, M. Chamorro (2022), *Las Exigencias Contenidas en la Propuesta de Diretiva sobre Diligencia Debida de las Empresas en Materia de Sostanibilidad y la Afectación Indirecta de Las Pymes*, in: 66 "Revista de Derecho de Sociedades", pp. 215-229; MOSCO, G. Domenico/ FELICETTI, Raffaele (2022), *The EU's Corporate Sustainability Due Diligence Directive: An Excessively Diligent Proposal*, 2 (available at https://blogs.law.ox.ac.uk/oblb/blog-post/2022/09/eus-corporate-sustainability-due-diligence-directive-excessively-diligent); LIDMAN, Erik/ HANSEN, J. Lau (2022), *Response to the Proposed Corporate Sustainability Due Diligence Directive by Nordic and Baltic Company Law Scholars*, 3 (available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/07/response-proposed-corporate-sustainability-due-diligence-directive). For similar concerns regarding equivalent national endeavours, where ill-defined obligations, distortion of international competition and problems for SMEs are also identified, see PIETRANCOSTA, Alain (2022), *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, 19 and 25, ECGI, Law Working Paper N° 639/2022.

[40] Public companies, private companies (Article 3(a)(i)), partnerships composed on undertaking organised in public or private companies (Article 3(a)(iii)), or any comparable form of legal person constituted in accordance with the law of a third country (Article 3(a)(ii).

to suffer the consequences therefrom[41]. Consider, for instance, a collective investment fund or a public pension fund with holdings in thousands of listed companies around the world: would it be reasonable or conceivable to require those funds to identify, prevent and bring to an end any potential or actual adverse human-social or environmental impacts at the level of all its portfolio companies and to expose their investors or pensioners to the risk of losing their investments and savings as a result of liabilities arising therefrom?

V. *D) Entity-Based Approach.* Finally, it is worth mentioning that the Proposal adopts an *entity-based*, rather than group-based, scope of application, meaning that the relevant legal thresholds (number of employees, net turnover) are measured at the individual *entity* level, not at the group level. Such an entity-centric approach, however, has two major shortcomings. One the one hand, it may result in an uneven playing field, enabling statutory evasion and regulatory arbitrage through the artificial use of the legal personality device: as it seems obvious, any business group may easily evade the application of the Directive by operating through a plurality of subsidiaries or legal entities none of which reach the relevant thresholds, or by ensuring that the ultimate parent is a holding company that does not exceed those thresholds[42]. On the other hand, this approach is surprisingly inconsistent with the solution adopted by others European laws of corporate sustainability matters. This is clearly seen in case of the "Non-Financial Report Directive" of 2014 (NFRD), which precisely imposes on companies a duty to publish a report that encourages certain large companies to conduct due diligence at the group level (known as the "sustainability report") with relevant triggers set up on a group-based and consolidated basis (Articles 19a and 29a of the Accounting Directive)[43]: therefore, a parent company of a large group that does not surpass the thresholds of CSDD (e.g., a holding company) would not be bound to exercise due diligence at the group level even though it might still

[41] See also NORDIC AND BALTIC COMPANY LAW SCHOLARS (2022), *Response to the Proposal for a Directive on Corporate Sustainability Due Diligence by Nordic and Baltic Company Law Scholars*, 16, Nordic & European Company Law Working Paper No. 22-01 (available at https://ssrn.com/abstract=4139249).

[42] This approach may also lead to the opposite result of subjecting in several companies to overlapping or duplicate due diligence duties: this would occur in cases where the parent company and a cascade of controlled subsidiaries individually reach the relevant thresholds (SØRENSEN, K. Engsig (2022), *Corporate Sustainability Due Diligence in Groups of Companies*, 3, Nordic & European Company Law Working Paper No. 22-02, (available at https://ssrn.com/abstract=4141862).

[43] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups. *See* also above 1.5 (II).

have to report on its due diligence actions following the NFRD[44]. In brief, the personal scope of the CSDD may induce artificial group organization while at the same time frustrating its own goals.

3. CONTENT

3.1. What is Due Diligence?

I. The core of the CSDD is to impose on companies operating in the European market a set of mandatory *due diligence duties* on human rights and environmental protection. The Proposal is titled a "due diligence" proposal, and the corporate duties are also referred to as "due diligence" duties.

II. *However, if one looks closer, it entails much more than that.* In European private law, due diligence typically refers to a special *way* of performing a certain duty or action, by assessing their risks before you commit yourself to it (think, for instance, about due diligence in M&A transactions)[45]. In contrast, under the CSDD proposal, due diligence means something else: it means a *set* or collection of specific legal duties imposed on corporations and other business entities concerning adverse human rights and environmental impacts resulting from breaches of international legal standards.

III. These duties are generally listed in Article 4 ("Due Diligence") and then specifically ruled in Articles 5 to 11 of the Proposal. In short, according to the CSDD proposal, companies are obligated to undertake the following actions:

- Integrate due diligence into all corporate policies and put in place a *general due diligence policy*, updated annually, which includes a description of the company's approach, a code of conduct, and procedures prepared for fulfilling the duty of care (Article 5);

[44] PARGENDLER, Mariana (2022), *The EU Proposal on Corporate Sustainability Due Diligence and the Mystique of Complete Corporate Separateness*, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/eu-proposal-corporate-sustainability-due-diligence-and-mystique.
[45] KÄSTLE, Florian/ SVERNLÖV, Carl (2023), *Legal Due Diligence in International M&A Transactions*, C.H. Beck/ Hart/ Nomos, München.

- Implement adequate measures to *identify* adverse human rights and environmental impacts, whether actual or potential, stemming from the company' activities (Article 6);
- Adopt adequate measures to *prevent* potential negative impacts or, if prevention is not possible, to mitigate them (Article 7);
- Take adequate measures to *bring to an end* any adverse impacts or, if cessation proves to be impossible, to minimize their magnitude, including the payment of financial compensations (Article 8);
- Establish a *complaint procedure*, that allows individuals or groups affected by an adverse impact to submit complaints on the issue (Article 9);
- *Monitor* the effectiveness of the due diligence policy and actions taken, by carrying out periodic assessments (Article 10); and finally
- *Publicly communicate* on due diligence, by preparing a sort of annual report on these matters (Article 11).

3.2. The Legal Nature of Due Diligence Duties

I. This plethora of duties also gives rise to a set a questions and observations regarding their legal nature, which will ultimately affect the practical application of the proposed directive. Here are just a few examples.

II. *A) International Law versus National Law*. Firstly, the CSDD will transpose a significant number of intergovernmental agreements (treaties) into national corporate laws (companies acts), thereby transmuting public obligations of States onto mandatory private legal duties applicable to corporations. As previously noted, international and national obligations differ fundamentally in their nature, scope and effects, reason why such a "transplant technique" is likely to introduce a notable level of uncertainty and potential for litigation in its application[46]. Moreover, this legislative initiative of the EU Commission says very much about the ostensible failure of States themselves, including European Member States, to enforce their own international obligations on human-social and environmental matters: by delegating and outsourcing the implementation of this

[46] *See* above 2.1 (II).

public obligations to private enterprises, some argue that the CSDD serves as a convenient *alibi* for national, European and international institutions[47]. Besides, it is rather suggestive that the Proposal totally overlooked the articulation between States and companies, or the interrelationships between international and national rules, in this "shared" crusade on people and environment.[48]

III. B) *Hard Law versus Soft Law*. The CSDD also aims to transpose and convert soft law recommendations – set out by international organizations like the UN and the OECD – into hard law corporate duties. However, mandatory legal obligations that are binding on corporations must be clearly designed and defined both from a juridical and a technical standpoint, especially when compared with mere voluntary guidelines, recommendations, and standards of conduct: this clarity is crucial since these obligations are intended to be enforceable in court, with public sanctions and civil liability associated with their violation. As the most part of the duties listed in Articles 5 and following of the Proposal are still rather vague and open-ended, formulated in a broad, soft law-like style, the definition of their precise content has ultimately been left to the national implementation of the relevant rules by Member States and/or through secondary legislation that may be adopted at either EU or national level. This mixed, blurry nature of the new EU due diligence duties – somewhere between soft and hard law – may result in the worst of both worlds: greater rigidity of legal rules compared to existing international guidelines while achieving less harmonization and homogeneity at the European level.

IV. *C) Obligation of Means versus Obligations of Result.* According to the Preamble of Proposal, the due diligence duties on social and environmental rights of Articles 4 and ff. should be understood as mere "obligations of means"[49]: thus, in line with the public international law nature of their underlying standards[50], companies covered by the CSDD

[47] RICHTER, M. Stella/ PASSADOR, M. Lucia (2022), *Corporate Sustainability Due Diligence: Supernatural Superserious*, 21, available at https://ssrn.com/abstract=4293912 .
[48] DAVIES, Paul (2022), *Ending Human Rights Abuses in which Companies and States are Complicit*, 1, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/ending-human-rights-abuses-which-companies-and-states-are-complicit.
[49] Recital 15: "Therefore, the main obligations in this Directive should be «obligations of means». The company should take the appropriate measures which can reasonably be expected to result in prevention or minimisation of the adverse impact under the circumstances of the specific case".
[50] *See* above 2.1 (II) and 3.2 (II). On the distinction, OLLINO, Alice (2022), *The Nature of Due Diligence Obligations*, in: "Due Diligence Obligations in International Law", pp. 64-130, Cambridge University Press, Cambridge (available at: https://doi.org/10.1017/9781009053082.003); WOLFRUM, Rüdiger (2011), *Obligation of Result Versus Obligation of Conduct: Some Thoughts About the Implementation of*

would not be required to attain a specified result or outcome (obligation of result) but simply to endeavour their best efforts towards such outcome or goal (obligation of means or conduct). This juridical qualification of the new legal duties raises some perplexities. Obligations of means typically allow significant leeway for uncertainty (leading to ambiguities and misinterpretations), evasion (providing a swift avenue to escape liability) and unaccountability (making it harder to hold obligees accountable for breaches of their obligations): therefore, ensuring compliance with those new legal duties and holding corporations accountable for their breaches will undoubtedly present a major challenge[51]. Additionally, the choice of the European legislation seems rather anachronic and outdated, especially when it is increasingly recognized by jurisprudence that corporate due diligence duties should be treated as obligations of result to ensure their effectiveness: a good illustration of this trend can be found in the landmark "Royal Dutch Shell" case (2021), where the Hague Court of Appeal qualified the duty of care in environmental matters for companies as an obligation of result, not of means, and that a company must prove that it has effectively cut its gas emissions, not merely that it has taken appropriate steps to do so[52]. Furthermore, the new due diligence duties not only encompass the adoption of adequate sustainability policies, risk management systems, monitoring devices, and compliance programs, but also require companies to attain or achieve concrete results or outcomes: consider, for instance, the duty to bring adverse impacts to an end, provided for by Article 8, which specifies a series or cascade of required actions such as neutralizing the impact, minimising its extent, seeking contractual assurances, making necessary investments, etc.

V. *D) Complexity versus Effectiveness.* It has become all too evident today that there is a close linkage between regulatory complexity and inefficiency: complex rules are often

International Obligations, in: Arsanjani, Mahnoush H. et al. (eds.), "Looking to the Future: Essays on International Law in Honor of W. Michael Reisman", pp., 363-383, Koninklijke Brill, The Netherlands.

[51] See also DEVA, Surya (2023), *Mandatory Human Rights Due Diligence Laws in Europe: A Mirage for Rightsholders?*, 407, in: 26 "Leiden Journal of International Law", pp. 389–414 (available at https://doi:10.1017/S0922156522000802).

[52] *Milieudefensie et. al. v. Shell Petroleum n.v*, of 29th January 2021 (*see* official English translation at https://uitspraken.rechtspraak.nl/details?id=ECLI:NL:RBDHA:2021:5339). On this landmark case, involving the famous British-Dutch multinational corporation of extraction, production and sale of oil and gas worldwide, *see* PETRA ŠKVAŘILOVÁ-PELZL, Petra/ ADAMS, Anaïs (2023), *The Duty of Due Diligence: A European Race to Corporate Responsibility and Sustainability?,* pp. 97ff., in: 34 (2) "European Business Law Review", pp. 193-212, available at https://kluwerlawonline.com/journalarticle/European+Business+Law+Review/34.2/EULR2023016.

ineffective as they make noncompliance more likely to occur[53]. The current EU regulatory framework or package on corporate and financial sustainability – namely, the Non-Financial Reporting Directive (NFRD), the Sustainable Finance Disclosure Regulation (SFDR), the Corporate Sustainability Reporting Directive (CSRD), and the Taxonomy Regulation (TR)[54] – is probably one of the major illustrations of such linkage, as its typical features of density, granularity, technicality, cross-referencing, and functional dependence, have admittedly caused serious problems to compliance[55]. The CSDD Proposal casts from the same mould. As a matter of fact, its rules are based on an extensive use of vague substantive concepts and complex compliance procedures that are largely unfamiliar to private corporate lawyers: terms as "due diligence policy", "appropriated measure", "potential adverse impacts", "established business relationship", "climate change", "value chain", "substantiated concern", "preventing", "mitigating" or "neutralizing" human-social and environmental impacts are just a few examples of the new "green" legal dialect. Although the Directive provides a general glossary of some of these concepts (e.g., Article 3(b)(c)(e) and(f)), the definitions are themselves rather open-ended, thus merely replacing indeterminate concepts with a number of others that are equally unclear, wrapping up the exact content and scope of the due diligence duties into a sort of hermeneutical mist. In addition, the Proposal foresees a lump of supplementary new rules in the form of delegated regulations (Article 11 and 18), model contractual clauses that companies can use when cascading obligations in their value chain (Article 12), technical guidelines for specific sectors or adverse impacts (Article 13), Member States' accompanying measures (Article 14) and administrative supervisory procedures (Articles 18 and ff.). While in theory these rules may seem helpful, in reality they are likely to increase overall regulatory complexity, thereby encouraging corporate

[53] While making regulation more precise and encompassing, complexity may lead to noncompliance for several reasons, including of economic (compliance with complex rules is more costly), normative (compliance with complex rules is perceived to be unfair) and organisational nature (complex rules are more difficult to implement). *See* NIELSEN, V. Lehmann/ PARKER, Christine (2012), *Mixed Motives: Economic, Social, and Normative Motivations in Business Compliance*, 430ff., in: 34(4) "Denver Journal of International Law & Policy", pp. 428-462 (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2336771)

[54] On this regulatory framework, *see* above 1.5.

[55] MEZZANNOTTE, Flex (2022), *EU Sustainable Finance: Complex Rules and Compliance Problems' Review of Banking and Financial Law*, available at https://blogs.law.ox.ac.uk/oblb/blog-post/2023/06/eu-sustainable-finance-complex-rules-and-compliance-problems-review-banking.

compliance through mere "box ticking" practices[56]. Form will triumph over substance, as usual.

VI. E) *Internal Tools versus External Tools*. It is generally recognized that business corporations have long generated serious externalities on people and on the planet. A central problem in the transition to a sustainable economy and society become then how to ensure that these negative human-social and environmental externalities and costs of business activity are internalised by corporations themselves.[57]

Since the outset, the European Union has adopted a regulatory strategy concerning the world sustainability challenge largely based on *internal* or *corporate law mechanisms*, i.e., on regulations focusing on the internal functioning and governance of corporations. Consider, for instance, the stewardship role of institutional investors and asset managers to develop, implement, and disclose an engagement policy in investee companies regarding their social and environmental impact (Article 3-G of the amended Shareholder Rights Directive, commonly known as SRD II); the obligation of companies to disclosure a "sustainability report" on environmental, social and human rights related impacts and measures (NFRD of 2014); the obligation of companies to facilitate investment and increase transparency concerning sustainable firms, products and services (SFDR of 2019 and TR of 2020); and the obligation of companies to provide information on their impact on people and the environment and to assess the financial risks and opportunities arising therefrom (CSRD of 2022). The new CSDD Proposal of 2022 represents a further step in this regulatory strategy, by basically upgrading the existing guidelines on corporate sustainability established by international organisation as UN and OECD into a sort of "soft-hard law mix" due diligence duties to which companies must now comply with.

[56] On the dangers of box-ticking compliance strategies in corporate governance, where the form prevails over substance, *see* REDDY, Bobby (2019), *Thinking Outside the Box – Eliminating the Perniciousness of Box-Ticking in the New Corporate Governance Code*, in: 82(4) "Modern Law Review", 692-726, available at https://www.modernlawreview.co.uk/july-2019/thinking-outside-box-eliminating-perniciousness-box-ticking-new-corporate-governance-code/.

[57] FISK, Peter (2010), *People, Planet, Profit: How to Embrace Sustainability for Innovation and Business Growth*, Kogan Page Publishers, London/ Philadelphia. On the role of modern corporations as actors of social and economic transformation, *see* GATTI, Mateo (2023), *Corporate Governing: Promises and Risks of Corporations as Socio-Economic Reformers*, ECGI Law Working Paper, available at https://www.ecgi.global/sites/default/files/working_papers/documents/corporategoverning_0.pdf.

Yet, there are reasons to questioning such a *corporate legal engineering* strategy. The European Commission justifies its ruling on corporate sustainability by emphasizing the relevance and urgency of reducing the negative human-social and environmental impacts of corporate activity and operations. However, it is precisely this relevance and urgency which cast serious doubts about whether such a strategy will ever ensure effective and timely results. At best, such a regulatory strategy would imply that the pace of the corporate internalisation of negative human and environmental externalities and the transition towards of a sustainable economy would be left to corporations themselves. At worst, it could operate as a regulatory licence to corporations to continue polluting the planet and violating labour and human rights, at the cost of draconian corporate bureaucracy (box-ticking), less dynamic corporate management (risk aversion) and higher risk of corporate litigation.[58]

In short, *sustainability is far too vital and urgent an issue to be left solely in the hands of corporations and their inner governance structures*. If sustainability is to be taken seriously, then a radical shift in perspective is necessary, moving from pure internal private mechanisms to *external and public tools*. Consider a classical and straightforward tool like a *carbon tax*: if corporations responsible for negative externalities to the environment where required to pay the costs of it (say, through a pollution tax), their incentives will automatically change, and thus corporate actions and strategies will automatically adjust to reduce their carbon footprint and to implement greener alternatives. While a carbon tax may not be a perfect instrument (needing to be supplemented by other sweeping public policy measures), the central point remains crucial: to avoid an eminent and irreversible environmental global collapse caused by the operations of business corporations, we must change the (external) rules of the game – by forcing *today* every company to internalize *directly* its human-social and environmental costs – rather than relying solely on changes of the (internal) rules of the players – trusting benignly that the compliance of their inner organization and governance with a menu of due diligence practices will lead *indirectly* to such cost internalisation somewhere *in the*

[58] To be sure, at the very end, it seems that there is a sole type of entities about which is safe to claim that such regulatory strategy will produce a benefit: the large *auditing and law firms*, which have found in the regulatory matrix of corporate sustainability a new and profitable segment of their activities.

future[59]. A similar regulatory strategy, based on external public instruments, could also be replicated in various other economic, social and business sector, such as energy (e.g., by amending accordingly Directive 2019/94/EC on electricity and Directive 2009/73/EC on gas), transportation (e.g., Regulation 443/2009/EU, on vehicle emissions), food (e.g., Regulation 1307/2013/EU, on common agriculture policy), real state (e.g., Directive 2010/31/EU, on energy performance of buildings), and so on.[60]

3.3. What is the Value Chain?

I. Another key aspect of the CSDD Proposal is that due diligence duties, "rectius", the adverse impacts on human-social and environmental rights, are to be assessed, not only at the level of the company and of its subsidiaries, but *throughout the entire company's value chain* (Article 1(1)(a)).[61]

II. Under the Proposal, the *"value chain"* company is defined to encompass "all the related activities of upstream and downstream entities having a business relationship with the company" (Article 3(g)). A business relationship is defined as "a relationship with a

[59] William NORDHAUS, a Yale Professor awarded the Nobel Prize in Economics (2018) for his work on the economics of climate change, reminded all of us of this simple but inconvenient truth at the Stockholm ceremony: "Economics points to one inconvenient truth about climate change policy. And that is that in order to be effective, the policies have to raise the price of carbon, or CO2, and in doing that correct the externality of the marketplace" (available at https://www.youtube.com/watch?v=h1RkSuAs03Q). Tariq FANCY, a former investment banker, put also it very bluntly: "It's kind of like making a basketball player pay fines whenever they cause harm to fans: if those costs are high enough, players will think twice before playing recklessly and instead find new ways to win cleanly (…). Instead, on sustainability issues we're currently being told that our hope lies in standing back and relying on some players sometimes deciding to pursue good sportsmanship, even if playing dirty helps them fulfil their legal duty to score maximum points" (*The Secret Diary of a "Sustainable Investor",* 5-6, available at https://pt.scribd.com/document/558847202/The-Secret-Diary-of-a-Sustainable-Investor-Tariq-Fancy).

[60] MCGAUGHEY, Ewan (2022), *How Can We Repower Europe? Ending Fossil Fuels and the Corporate Sustainability Due Diligence Directive*, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/05/how-can-we-repower-europe-ending-fossil-fuels-and-corporate.

[61] On this core topic, among many, *see* EUROPEAN COMMISSION, *Study on Due Diligence Requirements Through the Supply Chain – Final Report*, Publications Office, 2020 (available at https://data.europa.eu/doi/10.2838/39830); HIESSL, Christina (2023), *Labour Rights and Their Enforcement in Global Value Chains: The EU's Legislative Initiatives on Corporate ESG Due Diligence in Context*, in: 24(2), "ERA Forum - Journal of the Academy of European Law", pp. 201-215; LENNARTS, Loes (2023), *Civil Liability of Companies for Failure to Conduct Corporate Sustainability Due Diligence Throughout Their Value Chains - Is Art. 22 CSDDD Fit for Purpose?,* in: 5 "Ondernemingsrecht", pp. 257-267; MACKIE, Colin (2021*), Due Diligence in Global Value Chains: Conceptualizing "Adverse Environmental Impact",* in: 30(3) "Review of European Comparative & International Environmental Law", pp. 297-312; RUDLOFF, Bettina (2022), *Sustainable International Value Chains: The EU's New Due Diligence Approach as Part of a Policy Mix*, German Institute for International and Security Affairs Working Paper 2.

contractor, subcontractor or any other legal entities («partner») (i) with whom the company has a commercial agreement or to whom the company provides financing, insurance or reinsurance, or (ii) that performs business operations related to the products or services of the company for or on behalf of the company" (Article 3(e)). In short, the scope of due diligence duties includes the full range of activities, resources and relationships that a company employs and relies on regarding its products or services, regardless of their economic nature (e.g., conception, design, marketing, manufacture, storage, transport, distribution, sale, consumption, disposal, waste management) or involved actors (whether upstream and downstream, e.g., suppliers, employees, distributors, customers). Once again, there are reasons to believe that the hypertrophied scope and indeterminate formulation of this regulatory central concepts of the Proposal might lead to significant shortcomings in its practical application.

III. A) *Holistic Reach.* First and foremost, *in practical terms*, this means that any company (or, more accurately, any legal person[62]) covered by the Proposal holds due diligence duties, not only at the level of its own operations, not only at the level of the operations of all its subsidiaries, but *also at the level of each and every single business partner*, thus potentially all-embracing hundreds or maybe thousands of other companies or entrepreneurs. Needless to say, this inevitably makes compliance with those new duties very complex, very costly and (given the attached liability) very risky for recipient companies. This is especially true in regard of multinational corporations operating global value chains in complex environments. Take the example of Nestlé, which has 120,000 suppliers and 626,000 farmers[63]: one might wonder whether conducting an ongoing multi-tiered global analysis over hundreds of thousands of businesses partners in an effective manner would be feasible at all.[64]

IV. B) *Control versus Risk-Based Approach*. It can be inferred from the definitions under Articles 3(e), (f) and (g) that the CSDD Proposal adopts a mere "control-based" approach in prescribing the due diligence duties of companies concerning their business value

[62] *See* above 2.2. (V).
[63] Nestlé Supplier Portal, available at https://supplier.nestle.com.
[64] Also Gerard RUGGIE and J. F. SHERMAN (2017) underline that "conducting human rights due diligence can be difficult, especially in complex global value chains" (*The Concept of "Due Diligence" in the UN Guiding Principles on Business and Human Right),* 925, in: 28(3) "European Journal of International Law", pp. 921-98, available at https://academic.oup.com/ejil/article/28/3/921/4616676.

chains: this mean that can companies are bound to track all potential and actual impacts on people and environment across their entire value chain, looking indiscriminately to each and every one of their business partners and entities. However, this approach appears to be rather rigid, cumbersome and in the end ineffective, especially considering that business enterprises today – and value chains in particular – can be highly complex, involving multiple layers of upstream and downstream entities. For that reason, it would be advisable to adopt here an alternative "*risk-based" approach*: this approach – which was also endorsed by the existing international soft-law standards (including the UN and OECD Guidelines)[65] and even by the European Union itself in other initiatives of sustainability matters (such as sustainability reporting standards)[66] – focus on the *prioritization of risk based on the severity and likelihood of the adverse impacts* throughout the entire value chain[67]. Thus, companies should not be expected to go supplier by supplier, tier by tier, upstream and downstream until they uncover major problems: indeed, to do so would be a waste of resources while possibly overlooking material issues. Rather, they should look at the whole value chain to determine where risks to people and the planet are likely to be most significant, considering several criteria such as geographical areas, facilities or types of assets, inputs, outputs and distribution

[65] *See* the "UN Guiding Principles on Business and Human Rights": "Where business enterprises have large numbers of entities in their value chains it may be unreasonably difficult to conduct due diligence for adverse human rights impacts across them all. If so, business enterprises should identify general areas where the risk of adverse human rights impacts is most significant, whether due to certain suppliers' or clients' operating context, the particular operations, products or services involved, or other relevant considerations, and prioritize these for human rights due diligence" (Guideline 17 and Commentary).

[66] *See* Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards (OJ L /2772, 22.12.2023, pp. 1-284). Hence, under the Disclosure Requirement IRO-1 (Description of the process to identify and assess material impacts, risks and opportunities), companies are asked to disclose: b) an overview of the process to identify, assess and *prioritise* the undertaking's potential and actual impacts on people and the environment, informed by the undertaking's due diligence process, including an explanation of whether and how the process i) *focuses on specific issues due to heightened risk of adverse impacts*; ii) considers the impacts with which the undertaking is involved through its own operations or as a result of its business relationships; iii) […] iv) *prioritises negative impacts based on their relative severity and likelihood,* […].

[67] On the risk-based due diligence, see BRIGHT, Claire/ BUHMANN, Karin (2021), *Risk-Based Due Diligence, Climate Change, Human Rights and the Just Transition*, in: 13 "Sustainability", pp. 1-18, available at https://doi.org/10.3390/su131810454; LAFARRE, Anne (2022), *Mandatory Corporate Sustainability Due Diligence in Europe: The Way Forward,* 2, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/mandatory-corporate-sustainability-due-diligence-europe-way-forward; SCHIFT (2022), *EU Commission' Proposal for a Corporate Sustainability Due Diligence Directive*, 4 and 9, New York, available at https://shiftproject.org/wp-content/uploads/2022/03/Shift_Analysis_EU_CSDDProposal_vMarch01.pdf

channels: by focusing on high-risk areas, companies can prioritize their efforts and resources more effectively.

V. *C) Self-Centred, Bureaucratic and Costly Strategy.* The due diligence process has been conceived as a business-centric process. Despite the provisions granting actual or potential affected groups with some complaint and consultation rights (e.g., Articles 7(2)(a) and 9), it is most likely that oversight of the due diligence process across the value chain will be primarily handled by the companies' headquarters and by legal and audit consultants hired by them, ending up in a sort of a tokenistic or tick-box exercise[68]. Paradoxically, the extensive compliance, legal and audit costs of such an overly bureaucratic process may be externalised by those companies, spreading them among the upstream and downstream entities in their business value chain: given that a good deal of such entities are small and medium-sized enterprise, there is a significant likelihood that the cost of implementing the Proposal will have to be borne by SMEs.[69]

3.4. The Duty on Climate Change (Article 15)

I. Finally, alongside the general due diligence duties previously mentioned (Articles 4 and ff.), attention must be drawn to the specific and stand-alone duty on *"Combating Climate Change"* (Article 15). According to this provision, large companies are obligate to adopt a specific corporate plan for combating climate change (Articles 15(1)), that should also under certain circumstances include specific emission reduction targets (Article 15(2)) and be linked to the company's remuneration policy (Article 15(3)). This duty, however, seems rather odd for several reasons.[70]

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[68] Similarly, in relation to the French "Loi de Vigilance" (cf. above 1.4 (IV), also Elsa SAVOUREY and Stéphane BRABANT (2021) note that "a number of companies still approach the vigilance plan as a tick-box exercise and are wary of transparency and stakeholder engagement' (*The French Law on the Duty of Vigilance: Theoretical and Practical Challenges Since its Adoption*, 147, in: 6(1) "Business and Human Rights Journal", pp. 141-152, available at https://doi.org/10.1017/bhj.2020.30).

[69] *See* also above 2.2 (IV). The Proposal envisages a mitigation of this trickle-down effect through financial payments of the company to SMEs (Articles 7(2)(d) and 8(3)(e)). Since, as a rule, a SME is not in a position to insist upon their full financial entitlements from the company (particularly, given the latent threat of changing suppliers), the effectiveness of such provisions remains to be seen.

[70] On this specific provision, *see* EUROPEAN COMPANY LAW EXPERTS (2022), *Why Article 15 (Combating Climate Change) Should Be Taken Out of the CSDD*, available at https://www.ecgi.global/publications/blog/why-article-15-combating-climate-change-should-be-taken-out-of-the-csdd; HANSEN, S. Friies/ LILJA, M. Troels (2022), *Corporate Sustainability Due Diligence: Is*

II. *A) A Flawed Rule for Limiting Global Warming*. According to Article 15(1)[71], every large company is required to adopt a corporate plan compatible not only with the transition to a sustainable economy but also specifically with the limitation of global warming to a 1.5º degrees Celsius in accordance with the Article 2(1)(a) of the Paris Agreement[72]. This is clearly a flawed legal rule as the underlying benchmark of the duty is unsound both for technical, juridical and policy reasons. Limiting global warming to a 1.5 Cº is something clearly beyond the influence of any single company to achieve independently. Moreover, given the limited budget for overall carbon dioxide emission worldwide, it is likely that global warming will exceed the 1.5 Cº benchmark in any case, even if the whole EU were net-zero tomorrow. In other words, this provision is requiring companies operating in Europe to adopt a plan which has no reasonable prospect of being fulfilled at all. Therefore, if Article 15 were to remain in the Directive and to have some bite, the relevant benchmark should be replaced, namely by the net-zero transition goal of 2050 (as established by Regulation (EU) 2021/1119, of 30 of June).[73]

III. *B) Ineffective Benchmark.* Secondly, one has to bear in mind that the aforementioned benchmark is an international public law standard, which was neither intended nor designed to operate as a national and private law standard of duties directly applicable and enforceable to companies[74]. The Paris Agreement is an international treaty which, under Article 2(1), imposes on the contracting States an obligation to pursue efforts to limit the temperature increase to 1.5 degree above pre-industrial levels: this obligation is

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There a Legal Basis for the Proposed Art. 15?, Copenhagen Business School Law Research Paper Series No. 22-01, Copenhagen, available at https://ssrn.com/abstract=4075097.

[71] Art. 15/1: "Member States shall ensure that companies referred to in Article 2(1), point (a), and Article 2(2), point (a), shall adopt a plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 Cº in line with the Paris Agreement. This plan shall, in particular, identify, on the basis of information reasonably available to the company, the extent to which climate change is a risk for, or an impact of, the company's operations."

[72] Art. 2/1 of the Paris Agreement of 2015: "This Agreement, in enhancing the implementation of the Convention, including its objective, aims to strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty, including by: *(a)* Holding the increase in the global average temperature to well below 2 Cº above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5 Cº above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change". See KLEIN, Daniel/ CARAZO, M. Pía/ DOELLE, Meinhard/ BULMER, Jane/ HIGHAM, Andrew (2017), *The Paris Agreement on Climate Change: Analysis and Commentary*, 123 ff., Oxford University Press, Oxford/ New York.

[73] SCHLACKE, Sabine/ WENTZIEN, Helen/ THIERJUNG, Eva-Maria/ KÖSTER, Miriam (2022), *Implementing the EU Climate Law via the 'Fit for 55' Package*, in: 1 "Oxford Open Energy", pp. 1-13 (available at https://doi.org/10.1093/ooenergy/oiab002).

[74] On this legal nature of the underlying regulatory standards of the CSDD Proposal, *see* above 2.1. (IV).

a typical obligation of means, without any clear, precise, or unconditional effects, as the provision itself expressly states that its application presupposes that the parties to the Agreement shall adopt further implementing measures. By simply transplanting a treaty obligation to national company laws, Article 15 converts a public obligation of means of States into a private obligation of result of companies, thus conveying an inadmissible direct effect to an international Treaty.[75]

IV. *C) Regulatory Redundancy*. Thirdly, under the Regulation EU/2022/2464, of December 14th ("Corporate Sustainability Reporting Directive" or CSRD), large companies are already mandated to disclose a plan ensuring that its business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 Cº in line with the Paris Agreement (Article 19a(2)(a)(iii))[76]. Since Article 15/(1) is a duty with no reasonable prospect of fulfilment by companies or enforcement by courts, it is thus probable that it will ultimately become a mere redundant duplication of the disclosure duty provided by the CSRD.[77]

V. *D) Gas Emission Reduction Goals.* In addition to the duty to adopt a general plan on climate change combating, the Proposal also imposes a *special duty on emission reduction* to a subset of those companies (Article 15(2)): the climate plan of companies, where climate change is or should have been identified as a "principal risk" for its operations or the "principal impact" of them, must include specific emission reduction objectives or targets. Such an additional duty also raises several concerns.

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[75] The Paris Agreement was ratified by the European Union and its Member States, which binds only EU bodies and member states (Article 216(2) of Treaty of the Functioning of the European Union). While it is not completely excluded that a provision of a Treaty concluded between the EU and a third country could have direct effect on citizens and businesses in the EU, it is clear that the present case does not fulfil the conditions imposed by the European jurisprudence for such direct effect. Cf. HANSEN, S. Friies/ LILJA, M. Troels (2022), *Corporate Sustainability Due Diligence: Is There a Legal Basis for the Proposed Art. 15?* Copenhagen Business School Law Research Paper Series No. 22-01, Copenhagen (available https://ssrn.com/abstract=4075097).

[76] Wolf-George RINGE (2022) put it very bluntly: "While it is certainly true that a separate «plan» (under the CSDD) is likely to be more comprehensive and specific than a mere sub-part of the management «report» (under the CSRD), one cannot help but wonder about the additional benefit of the newly proposed plan. At worst, reporting is likely to be a lot of box-ticking and copy and paste in the future" (*Net-Zero Plans under the Proposed CSDD*, 2, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/net-zero-plans-under-proposed-csdd).

[77] Indeed, the requirement of Article 19a(2)(a)(iii) of the CSRD for companies to publish a climate plan that aligns with the 1.5 Cº benchmark *aiming to achieve climate neutrality by 2050* (as established in Regulation (EU) 2021/1119 on June 30th) sidesteps the flawed benchmark of Article 15(1).

"Primus", it *exposes the business strategy of companies to direct intervention and control by public entities*. As mentioned previously, the supervision of company's compliance with their due diligence duties is entrusted to a national supervisory authority (Article 17) which is vested with various powers, including taking remedial actions to non-compliant companies (Articles 18(4), 18(5)(a), 20(2) and 22(2))[78]: this implies that the supervisory authority would be allowed to influence and steering business strategy and decisions of subject companies by requiring them to adopt specific emission reduction objectives or to change existing ones[79]. Therefore, Article 15(2) provides indeed room for an external intervention of public and administrative entities of Member States in the strategy and governance of companies, potentially overriding the property rights of shareholders and the internal decision-making systems of corporations. Furthermore, given the existing EU regulatory framework on CO2 emissions (e.g., "European Financial Reporting Advisory Group"), such provision is likely to lead to regulatory overlapping and incoherence; and given the lack of necessary expertise and resources of national supervisory authorities to assess compliance with technical environmental rules (or the different degrees of preparation and scale among them), there are reasons to fear a considerable degree of legal uncertainty and inefficiency on application of Article 15(2), if not an uneven level of public intervention among European companies subject to the CSDD.[80]

"Secundus", one should not lose of sight of the fact that the exercise of external intervention and control on business plan and strategy of corporations can even be triggered by *private entities*. Since supervisory authorities are entitled to carry out investigations or interventions on the climate plan of companies based on "complaints" submitted by any affected stakeholders (Article 9) or "substantiated concerns" raised by

[78] On this administrative mechanism of enforcement, *see* below 4.1 (IV).

[79] See also NORDIC AND BALTIC COMPANY LAW SCHOLARS (2022): "There is a serious risk for it [Article 15] to be understood as a control mechanism. The difference is simple and crucial: if Article 15 is a disclosure obligation, then the content of the plan is decided by the company according to its internal governance system as determine in national company law. If, on the other hand, Article 15 is a control mechanism, then the content of the plan will be open to challenge if it is seen as insufficient in reaching the goal of Art. 15, thus enabling the decision-making process of the company to be overruled. It thus concerns the seminal question of who ultimately decides on the content of the plan" (*Response to the Proposal for a Directive on Corporate Sustainability Due Diligence by Nordic and Baltic Company Law Scholars*, 13, Nordic & European Company Law Working Paper No. 22-01, available at https://ssrn.com/abstract=4139249).

[80] EUROPEAN COMPANY LAW EXPERTS (2022), *Why Article 15 (Combating Climate Change) Should Be Taken Out of the CSDD*, 2, available at https://www.ecgi.global/publications/blog/why-article-15-combating-climate-change-should-be-taken-out-of-the-csdd.

individuals or legal persons (Article 19(1)), this means that the plan adopted by a company regarding climate change and its specific emission reduction targets can be challenged by virtually anyone, opening up a "pandora box".

"Tertius", the scope of the duty on climate change is likely to be undermined by *markets forces arbitrage*. To avoid the risks of legal uncertainty, external governmental interference and even frivolous litigation resulting from the duties imposed by Articles 15(1) and 15(2), companies may be compelled to divest from their most emission-intensive business and assets by selling them to other companies outside the scope of the CSDD. This well-known phenomenon of "brown-spinning" – involving large public companies selling of carbon-intensive assets to private players as a way to achieve their climate targets amidst increasing scrutiny from investors, regulators and the public – could thwart the ultimate goal of the global climate change, if not proving to be counterproductive: it goes without saying that divested assets will continue to operate in the same manner under the ownership of companies within or outside the scope of the CSDD, resulting in no overall net reduction in the greenhouse gas emissions related to such assets.[81]

VI. *E) "Green" Director's Remuneration.* Last but by no means least, the CSDD Proposal ties the remuneration policy to the company's climate plan (Article 15(3)): companies are required to take into account their climate-related obligations when setting their variable remuneration schemes, as far as it is linked to the contribution of a director to the company's business strategy and long-term interests and sustainability[82]. This fashionable "environmental" or "green" policy remuneration raises serious doubts. In fact, the Shareholder Rights Directive already includes rules on say-on-pay in listed companies, requiring that the remuneration policy must be aligned with corporate long-term interests and sustainability (Article 9a(6) of SRD II)[83]. By adding a new rule coordinating it with

[81] RINGE, Wolf-George (2022), *Private Companies, Brown-Spinning, and Climate-Related Disclosures in the U.S.*, Harvard Law School Forum on Corporate Governance, available at https://corpgov.law.harvard.edu.

[82] Article 15(3): "Member States shall ensure that companies duly take into account the fulfilment of the obligations referred to in paragraphs 1 and 2 when setting variable remuneration, if variable remuneration is linked to the contribution of a director to the company's business strategy and long-term interests and sustainability".

[83] Article 19a(6): "The remuneration policy shall contribute to the company's business strategy and long-term interests and sustainability and shall explain how it does so. It shall be clear and understandable and describe the different components of fixed and variable remuneration, including all bonuses and other

the existing ones concerning the long-terms and sustainability factors as metrics of the variable remuneration policy of corporations, the CSDD creates regulatory overlap or, at worst case, regulatory incoherence. More importantly, the very linkage between the climate plan and directors' remuneration, while trendy, is still problematic. Though "green remuneration" has rising support from stakeholder capitalism advocates, the use of environmental metrics – or even more broadly, the use of environmental, social, and governance (ESG) performance metrics – for directors' compensation remains both conceptually and empirically doubtful. A recent study about current practices of S&P 100 companies using ESG metrics, by tying remuneration to environmental, social, and governance factor, shown that they exacerbate the agency problem of executive pay (mainly serving the interests of directors and executives themselves) while having a very limited impact in the global environmental and societal welfare (serving a limited subset of shareholders at cost of the aggregate stakeholder welfare).[84]

4. SANCTIONS AND REMEDIES

4.1. What are the Enforcement Mechanisms?

I. Where there are obligations and duties, there should also be legal mechanisms to impose or implement them. Thus, what are the *enforcement mechanisms* of the due diligence duties?

II. Under the Proposal, there are 3 main types of enforcement mechanisms, presented in order of severity:

III. *A) Stakeholder Mechanisms*. Individuals or groups affected by the company's operations can submit complaints to the company (Article 9) and submit "substantiated

benefits in whatever form, which can be awarded to directors and indicate their relative proportion". Cf. NIJLAND, Jelle/ DIJKHUIZEN, Tom (2017), *Say on Pay and Focus on Sustainability of Companies: A Revised Shareholders' Rights Directive*, in: 14(5) "European Company Law", pp. 188-189, available at https://doi.org/10.54648/eucl2017028.

[84] BEBCHUK, Lucian/ TALLARITA, Roberto (2022), *The Perils and Questionable Promise of ESG-Based Compensation,* in: 48(1) "The Journal of Corporation Law", pp.37-75, available at https://jcl.law.uiowa.edu/sites/jcl.law.uiowa.edu/files/2023-01/BebchukTallarita_Online.pdf; MACEY, Jonathan (2022), *ESG Investing: Why Here? Why Now*?, in: 19(2) "Berkeley Business Law Journal", pp. 256-291, available at https://openyls.law.yale.edu/bitstream/handle/20.500.13051/18280/g.pdf?sequence=1&isAllowed=y.

concerns" to the supervisory authorities if a company fails to comply with the national provisions (Article 19).

IV. *B) Administrative Mechanisms*. Member States are required to designate a supervisory authority to oversee companies' compliance with their corporate DD duties. This authority is vested with significant powers, including the power to request information, to carry out investigations, to order the end of breaches, to order remedial actions and to impose pecuniary penalties to non-compliant companies (Article 17 to 20).

V. *C) Private Mechanisms*. Article 22 of the CSDD Proposal provides for the civil liability of companies failing to comply with their due diligence duties. Any company that fails to comply with its duties of preventing potential adverse impacts and of ending actual adverse impacts may be held liable for the damages resulting therefrom.

4.2. A New Enterprise Liability?

I. The later enforcement mechanism is particularly important, not only because it is a typical corporate hard law tool, but also because it has far-reaching implications: under CSDD, companies may be held liable for the damages stemming from, not only their own actions, *but also from the actions of their subsidiaries and all their supply chain partners*. In practical terms, this may introduce a *sort of group liability or even an enterprise liability* through the backdoor, making parent companies directly liable for damages caused by the failure of exercising due diligence concerning human rights and environmental adverse impacts at the level of the entire group and beyond – at *the level of the entire enterprise*.

II. This new system of group or enterprise liability also raises a lot of notable and unanswered questions regarding its implementation by national company laws of Member States. To start with, it is rather unclear whether the transposition of Article 22 will entail or not a *revision of corporate liability systems of national company laws*: questions such as who is entitled to enforce this liability (namely, will those harmed by the adverse impacts be given a right to sue the company in courts of a member state?) or what is distribution of the burden of proof (as liability will certainly not bite if victims must prove the breach of due diligence duties) are still without any consistent answer. On the opposite

direction, this new system seemingly provides *avenues for cutback or even exempting from liability*. Consider, for instance, Article 22(2), which states that when assessing and quantifying the company's liability for breaching of its due diligence duties, one should take into account the company's investment and efforts to set up an efficient compliance system. While provision may aim to strike a balance between "carrots and sticks" in corporate governance towards sustainability (to use the title of a most recent database)[85] – it directly contradicts the ban of liability safe havens adopted by the "United Nations Guiding Principles on Business and Human Rights" of 2011[86] and "OECD Due Diligence Guidance for Responsible Business Conduct"[87], the two most prominent international landmarks on sustainability due diligence on which the proposal was precisely inspired.[88]

5. DIRECTORS' DUTIES

5.1. Sustainable Corporate Governance

I. The most controversial provisions of the CSDD Proposal are the duties of the directors of the relevant companies, consisting of a duty of care of directors on sustainability matters (Article 25) and a duty to set up and supervise the company's due diligence policies (Article 26).

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[85] *Carrots and Sticks: Beyond Disclosure in ESG and Sustainability Policy – Annual Report September 2023*, which presents a comprehensive assessment of environmental, social and governance (ESG) and sustainability policy worldwide (available at https://www.carrotsandsticks.net).

[86] Guideline 17 (Commentary): "Conducting appropriate human rights due diligence should help business enterprises address the risk of legal claims against them by showing that they took every reasonable step to avoid involvement with an alleged human rights abuse. However, business enterprises conducting such due diligence should not assume that, by itself, this will automatically and fully absolve them from liability for causing or contributing to human rights abuses" (*Guiding Principles on Business and Human Rights*, p. 19, available at https://www.ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf).

[87] "The above characterisations are not intended to override any legal liability issues. Domestic law may have specific approaches or rules for determining relationship to impact for the purpose of informing legal liability" (*Due Diligence Guidance for Responsible Business Conduct*, p. 72, available at https://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf).

[88] LAFARRE, Anne (2022), *Mandatory Corporate Sustainability Due Diligence in Europe: The Way Forward,* 2, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/mandatory-corporate-sustainability-due-diligence-europe-way-forward. *See* above 1.4. (II).

II. Under the umbrella label of "Corporate Sustainability Due Diligence", the Proposal addresses in fact two distinct types of issues. One relates to *sustainability due diligence*. This is the obvious core of the Proposal (Article 1) and it consists mainly in a set of new legal obligations imposed on large corporations regarding the exercise of due diligence on adverse human rights and environmental impacts stemming from their value chain activities and operations (due diligence duties: Articles 4 to 11): there are duties of the corporation as a legal person and are intended to regulate their external relationships and conduct. But there is also another issue, somewhat hidden and concealed within a second regulatory layer of the Proposal, which relates to new mandatory rules on *sustainable corporate governance*. This less obvious issue, which is basically dealt in Articles 25 and 26, consists in specific fiduciary duties of care and oversight imposed on the directors of such corporations and are apparently aimed at redefining the content and scope of the internal governance and decision-making structure of the corporation itself. This two-tiered or twofold regulatory approach – which origins can be traced back to the European Green Deal[89] of 2019 and the studies commissioned for the European Union in 2020 (BIICL Report and EY Report)[90] – was originally conceived to be implemented through two separate legal instruments.

III. From the very outset, there has been strong criticism of integrating there two distinct issues (due diligence duties of companies and fiduciary duties of their directors) into a single Directive. In particular, the rules on corporate governance were heavily criticised

[89] "Sustainability should be further embedded into the corporate governance framework, as many companies still focus too much on short-term financial performance compared to their long-term development and sustainability aspects" (Communication from the Commission on the European Green Deal, 11 Dec. 2019, COM(2019) 640 final, at p. 17).

[90] BRITISH INSTITUTE OF INTERNATIONAL & COMPARATIVE LAW (2000), *Study on Due Diligence Requirements Through the Supply Chain* (the BIICL Report) and ERNST AND YOUNG (2000), *Study on Directors' Duties and Sustainable Corporate Governance* (the EY Report). *See* above 1.1 (II).

both by European[91] and American scholars[92] and were even rejected twice by the Regulatory Scrutiny Board of the European Commission itself[93]. One may thus say that the provisions of Articles 25 and 26 (along also with Article 15) are the remnants of the European Commission' original ambitious plan to harmonize directors' duties and corporate governance as a driver for sustainable corporate governance. However, there are reasons to question whether this regulatory strategy is accurate and, thus, whether these brand-new fiduciary duties of directors are sound.

5.2. The Duty of Setting up and Overseeing Due Diligence

I. Article 26 ("Setting up and overseeing due diligence") deals with the responsibility to establish, implement, and supervise the companies' due diligence policies. While still

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[91] Among many, *see* BASSEN, Alessander/ LOPATTA, Kerstin/ RINGE, Wolf-Georg (2021), *The EU Sustainable Corporate Governance Initiative – Room for Improvement*, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2020/10/ec-corporate-governance-initiative-series-eu-sustainable-corporate; EUROPEAN COMPANY LAW EXPERTS GROUP (2020), *A Critique of the Study on Directors' Duties and Sustainable Corporate Governance Prepared by Ernst & Young for the European Commission*, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2020/10/ec-corporate-governance-initiative-series-critique-study-directors; EUROPEAN COMPANY LAW EXPERTS GROUP (2022), *Legal Certainty and the Directive on Corporate Sustainability Due Diligence*, available at https://www.ecgi.global/publications/blog/legal-certainty-and-the-directive-on-corporate-sustainability-due-diligence; HANSEN, J. Lau (2000), *Unstainable Sustainability*, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/03/unstainable-sustainability; LIDMAN, Erik (2022), *The Role of Corporate Governance in Sustainability and Why Commission CSDDD Proposal Might Do More Harm Than Good*, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/role-corporate-governance-sustainability-and-why-commissions-csddd; MOSCO, G. Domenico/ FELICETTI, Raffaele (2022), *The EU's Corporate Sustainability Due Diligence Directive: An Excessively Diligent Proposal*, available at https://blogs.law.ox.ac.uk/oblb/blog-post/2022/09/eus-corporate-sustainability-due-diligence-directive-excessively-diligent; MÖSLEIN, Florian/ SØRENSEN, K. Engsig (2021), *Sustainable Corporate Governance: A Way Forward*, available at https://doi.org/10.54648/eucl2021002; NORDIC AND BALTIC COMPANY LAW SCHOLARS (2022), *Response to the Proposal for a Directive on Corporate Sustainability Due Diligence by Nordic and Baltic Company Law Scholars*, available at https://ssrn.com/abstract=4139249; RICHTER, M. Stella/ PASSADOR, M. Lucia (2022), *Corporate Sustainability Due Diligence: Supernatural Superserious*, available at https://ssrn.com/abstract=4293912; THOMSEN, Steen, *Sustainable Corporate Governance and the Road to Stagnation,* available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/sustainable-corporate-governance-and-road-stagnation.

[92] HARVARD LAW SCHOOL (2021), *Law and Business Professors' Submission to the EU on EY's Study on Directors' Duties and Sustainable Corporate Governance – Response to the European Commission's Call for Feedback on its Sustainable Corporate Governance Initiative*, available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/F594640_en; ROE, Mark J./ SPAMANN, Holger/ FRIED, Jesse M./ WANG, Charles C. (2022), *The European Commission's Sustainable Corporate Governance Report: A Critique*, Harvard Public Law Working Paper No. 20-30, available at http://dx.doi.org/10.2139/ssrn.3711652.

[93] Following what Jesper Lau HANSEN (2021) described as a "zombie" resurrection (*Zombies v. Subsidiarity*, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2021/10/zombies-v-subsidiarity-opening-8-december-2021).

aligning with the general scope of a Directive on due diligence duties of companies, one may question whether this provision is necessary at all.

II. The first paragraph of such rule, which states that directors are responsible for implementing and overseeing the due diligence actions referred to in Article 4, and in particular the due diligence policy referred to in Article 5[94], seems to be rather superfluous. As a matter of fact, given that these due diligence policy and actions are legal duties or obligations of the company, it would logically follow from the system of allocation of powers of national company laws – which entrust the board of directors with the authority to act on behalf of the company – that directors would have the responsibility of putting in place and overseeing such policy and actions.[95]

II. Something similar could be said about the second paragraph, which mandates directors to adapt the corporate strategy to actual or potential adverse human rights and environmental impacts[96]. Once more, not only would the accommodation of the strategy of the company be usually an implied effect of the identification of such adverse impacts (due to the liability associated with such impacts: cf. Article 22), but also because it would be an expected outcome of the duty of monitoring of the board, provided by Article 10, which expressly requires a mandatory periodical assessment of the company's operations and measures regard those impacts.

IV. All in all, Article 26 appears to be rather *superfluous provision*, as its main substantive content and effects would likely result from the straightforward application of ordinary company law rules regarding the powers and duties of the board of directors of a corporation.

[94] Article 26(1): "Member States shall ensure that directors of companies referred to in Article 2(1) are responsible for putting in place and overseeing the due diligence actions referred to in Article 4 and in particular the due diligence policy referred to in Article 5, with due consideration for relevant input from stakeholders and civil society organisations. The directors shall report to the board of directors in that respect".

[95] The additional remark that, when performing this implementation and supervision duties, the directors have also to take "due consideration for relevant input from stakeholders and civil society organisations", would also result already from other provisions of the Directive, e.g., Articles 6(4), 7(2)(b) and 8(3)(b) (consultations with stakeholders) and 9(2)(c) (complaints submitted by civil society organisations).

[96] Article 26(2): "Member States shall ensure that directors take steps to adapt the corporate strategy to take into account the actual and potential adverse impacts identified pursuant to Article 6 and any measures taken pursuant to Articles 7 to 9".

5.3. The Duty of Care

I. Article 25 ("Directors' duty of care") encompasses, *but goes beyond*, the primary goal of inducing corporations to adopt due diligence policies and measures for the protection of human rights and the environment. *It appears to redefine the general duty of care* of large companies already outlined in existing national company laws of Member States, in two ways: firstly, by imposing on directors an obligation to consider the consequences of their decisions for sustainability matters (Article 25(1))[97] and, secondly, by directly holding them accountable for any breach of that obligation (Article 25(2))[98]. This provision raises several questions both from a technical and policy standpoint.

II. *A) A Dual System of Fiduciary Duties?*. In first place, if transposed into national company laws of Member States, this provision will indeed create a sort of two-fold or differentiated system of fiduciary duties of directors, especially concerning the duty of care: a general duty of care – currently the sole duty in force in national company laws and applicable to companies in general – and a new specific duty of care – relevant and applicable only to a smaller subset of large-sized companies subject to the Directive (including non-corporate forms used by financial undertakings). Given that the existing unitary system on directors' fiduciary duties is already acknowledged to be a source of considerable difficulties in interpretation and application, one can only speculate about the level of controversy and challenges that would arise with the implementation of such a new dual system, particularly concerning its internal consistency.

III. *B) The Dubious Qualification of the New Duty*. In comparative company law is has become common to categorize fiduciary duties of directors into a duty of care ("deber de diligencia", "Sorgfaltspflicht", "devoir de diligence", "obbligo di diligenza") and a duty of loyalty ("deber de lealtad", "Treuepflicht", "deber de lealdad", "obbligo di fedeltà").[99]

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[97] Article 25(1): "Member States shall ensure that, when fulfilling their duty to act in the best interest of the company, directors of companies referred to in Article 2(1) take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term".

[98] Article 25(2): "Member States shall ensure that their laws, regulations and administrative provisions providing for a breach of directors' duties apply also to the provisions of this Article".

[99] On this traditional dual categorisation of directors' fiduciary duties, in different legal orders, *see* ABELTSHAUSER, Thomas (1998), *Leitungshaftung im Kapitalgesellschaftsrecht – Zür Sorgfalts- und Loyalitätspflichten von Unternehmensleitern im deutschen und US-amerikanischen*

Although the line between these two types of duties is not absolutely clear, it is generally understood that they correspond to different standards of conduct: while the former dictates that directors must exercise care, skill and diligence while performing its task, the latter requires that directors must act in the interest of the company[100]. From this perspective, there appears to be an enigmatic inconsistency between the designation and the content of Article 25: while this provision is labelled as a "duty of care" of directors, it explicitly refers to "[the fulfilment of] their duty to act in the best interest of the company". This inconsistency has a significant practical implication: since in the vast majority of European jurisdictions (as well as non-European ones), a director's duty to act in the best interest of the company primarily pertains to their duty of loyalty – rather than their duty of care –, it is likely to introduce an additional challenge in implementing the Directive, as the transposition of Article 25 would probably require the rebranding or reformulation of those fiduciary duties in national Companies Acts.[101]

IV. *C) Broad Concept of Diretor*. While imposing an obligation of care on the "directors of companies" (Article 25(1)) and providing a liability for the "breach of director's duties" (Article 25(2)), the Proposal adopts a rather broad definition of director (Art. 3/o). This notion encompasses, not only the members of the board of directors, but also individuals serving other corporate roles, such as the members of supervisory board in a two-tier system, as well as other persons which functionally, though not formally, may hold managerial positions in the company (such as CFOs, deputy CFOs, or even shadow directors)[102]. Such a wide notion expands the personal scope of the new duties and liabilities of the board of directors provided for by Article 25, as it imposes them on individuals which are not in fact members of that board.

Kapitalgesellschaftsrecht, 49ff., 271 ff., Carl Heymanns, Köln; MORTIMORE, Simon (ed.) (2017), *Company Directors – Duties, Liabilities and Remedies,* 3rd edition, pp. 237ff., Oxford University Press, Oxford.

[100] *See* CAHN, Andreas/ DONALD, David (2018), *Comparative Company Law,* 393ff., 2nd edition, Cambridge University Press, Cambridge.

[101] Guido FERRARINI, Michele SIRI and Shanshan ZHU (2021) rightly pointed out that "the reference to the duty of care is not entirely appropriate, given that the duty of loyalty is primarily at play when the directors are required to act in the company's interest" (*The EU Sustainable Governance Consultation and the Missing Link to Soft Law*, 19, ECGI Law Working Paper No. 576/2021 (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3823186).

[102] Art. 3/(o): "'Director' means: (i) any member of the administrative, management or supervisory bodies of a company; (ii) where they are not members of the administrative, management or supervisory bodies of a company, the chief executive officer and, if such function exists in a company, the deputy chief executive officer; (iii) other persons who perform functions similar to those performed under point (i) or (ii)".

V. *D) "The Interest of the Company"*. The concept of the "interest of the company" is widely acknowledged to be an inherently blurred concept, which carries various meanings in many jurisdictions while being even unfamiliar in some others. Rather than being a clear and operational legal standard, the interest of the company often serves merely as one of many proxies in the endless centenary "Dodd-Berle" debate concerning the fundamental purpose of corporations ("for whom are corporate managers trustees")[103]. Remember that, from a comparative doctrinal viewpoint, the «interest of the company», or its national equivalents ("Unternehmensinteresse", "intérêt social"), can be understood in at least two different senses: one is the traditional monistic perspective, based on a property view of the company and the corresponding principle of shareholders primacy, according to which the interest of the company equals basically to the interests of their shareholders or owners; conversely, there is another "new" pluralistic perspective, based on an institutional view of the company as an entity composed of plurality of constituencies or stakeholders, according to which the interest of company would be the result of the balance of the interests of shareholders and the interests of a variety of stakeholders[104]. Needless to say, incorporating such a polysemic concept into Article 25, would likely be a source of increase legal uncertainty, hindering rather than aiding harmonization efforts towards a European corporate sustainability regulatory framework.

VI. *E) The Regard Clause*. The "pièce de résistance" of Article 25 is the introduction of a specific "regard clause": according to its paragraph 1, when fulfilling their duty to act in the best interest of the company, directors shall "take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term."[105]. The practical outcome of such a regard clause for the overall interpretation and

[103] DODD, E. Merrick (1932), *For Whom Are Corporate Managers Trustees?* (1932), in 47 (7) "Harvard Law Review", pp. 1145-1163, and BERLE, Adolf (1932), *For Whom Corporate Managers Are Trustees: A Note*, in: 45(8) "Harvard Law Review", pp. 1365-1372.

[104] The literature on this standard is almost as extensive and inconclusive as the standard itself: *see*, for instance, FLEISCHER, Holger (2018), *Comparing Unternehmensinteresse and Intérêt Social: A Guided Tour Through Last Century's Corporate Law History in Germany and France*, in: 18(4) "Revue Trimestrielle de Droit Financier", pp. 15-22.

[105] On this type of clauses – sometimes known also as "consideration clauses" or "interested parties clauses" –, see MONTALENTI, Paolo (2010), *Interesse Sociale e Amministratori,* 91, Giuffrè Editore, Milano; SEGRESTIN, Blanche/ HATCHUEL, Armand/ LEVILLAIN, Kevin (2021), *When the Law Distinguishes Between the Enterprise and the Corporation: The Case of the New French Law on Corporate Purpose*, 7, in: 171 "Journal of Business Ethics", 1-13, available at https://doi.org/10.1007/s10551-020-04439-y.

scope of the provision at stake is, of course, a matter of concern. From a purely formal viewpoint, the formulation of Article 25 echoes the definition of the fiduciary duties of directors adopted by those national company laws that, while centred on the best interest of the company, establish a set of secondary or subordinated interests that directors must also consider when doing so. A clear example of these regard clauses is section 172 of the UK Companies Act 2006: this section, which codified the common law duty of loyalty to act in the best interests of the company, broadly states that the duty of directors to achieve the success of the company for the benefit of shareholders should be performed by having regard to, or taking into account (amongst others), the interests of wider constituencies, like employees, customers, suppliers, the community and the environment, and the consequences of directors' decisions in the long term. Since such a provision of the English Companies Act is still based on the traditional principle of shareholders primacy[106], the regard clause included in Article 25 deepens rather than diminishes the doubts around its exact sense and scope.[107]

VII. *F) Time Horizon.* In addition to the aforementioned "regard clause", the provision also contains a final remark: when fulfilling their duty of care, directors should consider the consequences of their decisions for sustainability matters "in the short, medium and long-term" (Article 25(1), "in fine").

The significance and objective of this time factor are nebulous. Taken literally, it appears rather superfluous, as it merely states the obvious: since companies are ongoing business endeavours, a prudent and diligent director, acting in accordance with a fiduciary standard of care, would always be reasonably expected to identify and evaluate the effects (both

[106] According to the prevailing interpretation, section 172 of the UK' Companies Act enshrines the so-called *"enlightened shareholder value"* (ESV) doctrine, according to which directors are bound to pursue the primary interest of shareholders (shareholder value), while also considering the impacts (risks and opportunities) on other stakeholders in the pursuit of long-term shareholder value maximization ("enlightened" shareholder value). *See* DAVIES, Paul (2008), *Principles of Modern Company Law*, 506ff., 8th edition, Thomson/ Sweet & Maxwell, London.

[107] AGOSTINI, Federica/ CORGALETI, Michele (2022), *Article 25 of the Proposal for a Directive on Corporate Sustainability Due Diligence: Enlightened Shareholder Value or Pluralist Approach?*, 93ff., in: 19(4) "European Company Law Journal", pp. 92–99, available at https://eprints.gla.ac.uk/276788/1/276788.pdf.

positive and negative) of their decisions over different scales of times, in order to appropriately balance and trade-off overall risks and opportunities.[108]

Hence, a more plausible explanation would be to interpret this additional remark as a reminder of the original policy objective of the European Commission to establish a framework for "sustainable corporate governance"[109]. This policy objective, rooted in a Manichaean antagonism between shareholders' interest short-termism and long-term interests of sustainability and other stakeholders, seek admittedly to redefine the current system of corporate governance and directors' duties: in the view of the Commission, existing company law incentivizes companies and their directors to prioritize the short-term interests of shareholders (profit maximization) over the long-term interests of the company and its stakeholders, including sustainability[110]. However, as already mentioned above, the theoretical and empirical premisses of this perspective have faced extensive criticism from both the business and academic communities in the EU and the US[111], especially highlighting the erroneous assumption of a causal linkage between corporate short-termism and the negative externalities of corporate activities[112]. Unsuspectingly, these misconceptions were underscored by Professor John Ruggie, the architect of the "UN Guiding Principles on Business and Human Rights" (2011), widely acknowledged as the most significant soft law international initiative that influenced the new mandatory

[108] On the question how do organizations balance short-term profitability and long-term environmental sustainability when making supply chain decisions under conditions of uncertainty, *see* WU, Zhaohui/ PAGEL, Mark (2011), *Balancing Priorities: Decision-Making in Sustainable Supply Chain Management*, in: 29(6) "Journal of Operations Management", pp. 577-590, available at https://doi.org/10.1016/j.jom.2010.10.001.

[109] *See* above 5.1.

[110] *European Commission Consultation Document Proposal for an Initiative on Sustainable Corporate Governance* (2020): "Sustainability in corporate governance encompasses encouraging businesses to consider environmental (including climate, biodiversity), social, human and economic impact in their business decisions, and to focus on long-term sustainable value creation rather than short-term financial value" (available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/public-consultation_en). This general view was clearly expressed in the *"Study on Directors' Duties and Sustainable Corporate Governance"* (2020), commissioned by the European Commission which points out to a "trend for publicly listed companies within the EU to focus on short-term benefits of shareholders rather than on the long-term interests of the company" and "to promote a focus on short-term financial return rather than on long-term sustainable value creation" (p. vi). *See* also above 1.1.

[111] *See* above 5.1. (III), in particular fn 91 and 92.

[112] *Law and Business Professors' Submission to the EU on EY's "Study on Directors' Duties and Sustainable Corporate Governance" – Response to the European Commission's Call for Feedback on its Sustainable Corporate Governance Initiative* (2020), 2 and ff. To the fallacies of stakeholderism, *see* extensively BEBCHUK, Lucian/ TALLARITA (2020), Roberto, *The Illusory Promise of Stakeholder Governance*, in: 91 "Cornell Law Review", pp. 106-177, available at https://www.cornelllawreview.org/wp-content/uploads/2021/02/The-Illusory-Promise-of-Stakeholder-Governance.pdf.

rules of the CSDD Proposal: indeed, as he put it, "directors are not the main driver of short-termism" and amending director's duties "may be largely unnecessary, because a properly constructed mandatory due diligence requirement itself will significantly change directors' duties in the desired direction".[113]

VIII. G) *Enforcement Problems*. The transposition of this duty of care outlined in Article 25 into national company laws may also present other challenges.

One issue concerns the articulation of this new fiduciary duty of directors with the *business judgment rule*, adopted in US and several European jurisdictions[114] – an issue that remains unaddressed in the Proposal. This omission is tricky because the scope, content and extent of liability of directors for breaching their due diligence duties (whether in the realm of corporate sustainability or any other aspect of management decision-making) are closely intertwined with this rule: it is worth noting that, except for cases of fraud or mismanagement, decisions made by directors who act on an informed basis, free from personal conflicting interests, and in good faith in what they believe to be the best interests of the company, are generally not subject to judicial review. While the coordination and interaction between this general company law liability standard and the specific duty of Article 25(1) remains unclear, it appears that the business judgement rule may serve an important restriction or limitation of the ability of the affected stakeholders to trigger the liability of directors under Article 25(2).

Another issue pertains to the alignment of the breach of this new duty with the current *enforcement system of directors' liability* – which the Proposal again fails to address. Indeed, existing enforcement systems in most of European national company laws were crafted to empower shareholders as the primary complainants, enabling them to bring a derivative claim for breach of directors' duties, while in contrast stakeholders (like creditors, employees, consumers, and other constituencies) are typically granted access

[113] RUGGIE, John (2021), *European Commission Initiative on Mandatory Human Rights Due Diligence and Diretors' Duties*, 1, available at https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/EU%20mHRDD.pdf.
[114] RADIN, Stephen (ed.) (2009), *The Business Judgment Rule: Fiduciary Duties of Corporate Directors,* 6th edition, Wolters Kluwer Law & Business, New York; OLTMANNS, Martin (2001), *Geschäftsleiterhaftung und Unternehmerisches Ermessen – Die «Business Judgment Rule» im deutschen und im amerikanischen Recht*, Peter Lang, Frankfurt am Main.

to judicial remedy only under very limited circumstances[115]. The Proposal's omission of specific and uniform procedural rules for stakeholders, coupled with the delegation of such a task to national authorities (Article 25(2))[116] – may lead to two undesirable different outcomes. Some national jurisdictions might consider maintaining the existing procedural and judicial mechanisms, albeit with minor adaptations: in this scenario, the protection of the stakeholders' interests may prove ineffective or even rendered moot. In contrast, some other jurisdictions may opt for a more ambitious approach by introducing entirely new enforcement rules, which is a likely given the emphasis placed on stakeholders in numerous substantive rules throughout the CSDD Proposal (for instance, Articles 3(n), 6(4), 7(2)(a), 8(3)(b), 13, and 19): in such a scenario, the legal standing to initiate judicial actions against directors would be extended to a vast array of corporate constituencies and stakeholders, including company's employees, customers, suppliers, even diffuse interests such as the environment, and virtually any person damaged by any adverse human rights and environmental impacts caused by the failure of the company to comply with its due diligence obligations.[117]

IX. *H) Negative Economic Side-Effects on Corporate Management.* Lastly, the new rules of directors' duties and liabilities outlined in the CSDD Proposal may indeed lead to *risk aversion in management*, potentially impairing the creation of value of companies. As

[115] This is largely confirmed by judicial practice, even in jurisdictions that adopt a regard clause binding directors to take into consideration the interests of stakeholders and other corporate constituencies. For example, in the UK, there has been only one (unsuccessful) claim under section 172 of the Companies Act for environmental reasons, yet brought by an NGO in its capacity as a shareholder (GIBBS-KNELLER, David (2022), *No Real Prospect for Success: Client Earth's Derivative Litigation Against the Directors of Shell*, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/no-real-prospect-success-clientearths-derivative-litigation-against). As a result, commentators often argue that courts are only likely to scrutinize a breach of section 172 if another constituency has been completely disregarded (LOUGHREY, Joan/ KEAY, Andrew/ CERIONI, Luca (2015), *Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance*, 94, in: 8(1) "Journal of Corporate Legal Studies", pp. 79-11, available at https://doi.org/10.1080/14735970.2008.11421523).

[116] A further shortcoming is the absence of specific rules regarding *the distribution of the burden of proof* and *the costs of litigation* – an issue acknowledged by the Proposal itself ((Recital 58: "the liability regime does not regulate who should prove that the company's action was reasonably adequate under the circumstances of the case, therefore this question is left to national law"). This failure to address the crucial issue of where to place such enforcement burden and costs may well undermine the effectiveness of the liability system, leaving the choice to national legislators. *See* also PACES, Alessio (2022), *Supply Chain Liability in the Corporate Sustainability Due Diligence Directive Proposal*, 2, available at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/supply-chain-liability-corporate-sustainability-due-diligence.

[117] According to art. 3/n), 'stakeholders' means the company's employees, the employees of its subsidiaries, *and other individuals, groups, communities or entities* whose rights or interests are or could be affected by the products, services and operations of that company, its subsidiaries and its business relationships".

directors are obligated to consider any adverse human, social, and environmental impacts of their decisions across the entire value chain of the company, the prospect of facing extensive, diffuse, and uncertain liability in case of breaching such duties is likely to create a chilling effect on managerial decisions (e.g., establishing bureaucratic procedures along the value chain or exit company's operations from underdeveloped countries to mitigate risks) and accordingly lowering the financial value but also the social value of the company (as such exit can lead to deglobalization and welfare loss in economically vulnerable countries).

Another probable negative side-effect is the *insulation and entrenchment of the board of directors* within the governance structure of corporations, by paradoxically increasing the powers of directors while at the same times decreasing their accountability towards shareholders. To be true, the traditional governance paradigm of shareholder primacy is a powerful mechanism to ensure that directors are aligned with the welfare of the company while restraining their freedom in managing its affairs. As long as directors are hired and fired by shareholders (ownership), their compensation is tied to the financial performance of the firm (incentive-based compensation), and their low performance leads to swift replacement as a consequence of takeovers (market for corporate control), it is highly likely that the conduct of directors will be aligned with the goal of financial success of the company and profit maximization for their shareholders. However, if one replaces this paradigm with another where directors are required to pursue a plethora of other corporate constituencies' interests – extremely varied, ambivalent, and sometimes even mutually conflicting (creditors, employees, customers, suppliers, community, environment, etc.) – and in the context of a flexible regulatory framework – comprised of open-ended or fluid formulas providing no precise guidance ("interest of the company," "regard clause," "climate change," etc.) –, this new paradigm is likely to generate a true *paradox*: instead of further constraining managers, it will expand managerial discretion, as the rationale of any decision or action of corporate directors could be justified on some ground or another[118]. Take car manufacturers and oil companies: their employees' interest in stable

[118] The hurdles of this shift of paradigm would be particularly notorious in European jurisdictions, where publicly-traded companies are typically controlled by a majority shareholder: as pointed out by Alperen Afşin GÖZLÜGÖL (2022), "in the presence of such a shareholder, the attempt to modify directors' duties may fail to achieve more sustainability" (*Controlling Shareholders: Missing Link in The Sustainability Debate?,* 1, in: https://blogs.law.ox.ac.uk/business-law-blog/blog/2021/07/controlling-shareholders-

employment and their customers' interest in reliable and inexpensive individual transportation are, at least theoretically, in tension with the interests of the environment and local communities affected by excessive pollution. All in all, the provision of Article 25(1) would entrust corporate directors with a significant margin of discretionary choice in managing investors' money, surreptitiously providing them with new avenues to escape shareholder control and civil liability, except in cases of egregious mismanagement or fraud. Above all, it would enthrone the boards of directors of the world's largest corporations as the *new political 'oracles' of the 21st century*, vested with the power to decide complex trade-offs between broad societal and environmental interests. These are typically public decisions that belong to the power and responsibility of States and their officials elected by citizens and cannot simply be handed over and delegated to corporate boards and their officials elected by shareholders.

X. In view of all these shortcomings, one may ask whether the proposed harmonization of director's duties is still in line with the general *principles of subsidiarity and proportionality* of the Treaty and, therefore, whether it such harmonisation is *necessary and helpful* to the overall purpose of the Directive itself.

6. CONCLUDING REMARKS

I. A Directive aiming to align corporations with the goal of transition to sustainable economies and societies is certainly commendable and important. However, if the Proposal is adopted in its current form, *it is likely to miss the target*, while at the same time increasing legal uncertainty, compelling a draconian bureaucracy, foster greater risk aversion and reduce competitiveness of businesses.

II. To begin with, the Proposal of Directive of Corporate Sustainability Due Diligence says worlds about *the failure of States to uphold with their own international obligations*

missing-link-sustainability-debate). But it is present as well in non-European jurisdictions, as pointed out by A. Gurrea MARTINEZ (2022): "Ironically, well intentioned initiatives seeking to promote responsible capitalism could end up doing more harm than good for the advancement of sustainability and long-term growth" (*Sustainability and Corporate Governance in Latin America*, 3, in: https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/06/sustainability-and-corporate-governance-latin-america).

regarding human rights and environmental protection. After years of intense controversy, the European Commission justified its proposal by emphasizing the "urgency of action" on sustainability issues. Urgent action is necessary, indeed. However, it is hard to believe that redesigning corporate governance models alone could ever meet such urgency, and timely prevent or deter the global environmental and social disaster where you are heading now quickly: no one can really expect that crucial tasks such as cutting carbon dioxide emissions to zero, preserving biodiversity, safeguarding human and social rights, and halting further global temperature increases, is something to be left to the governance of business corporations themselves. By delegating and outsourcing the implementation of these core public obligations to private enterprises, the Proposal offers thus a convenient *alibi* for States and international organizations to dismiss from their unique historical responsibilities.

III. Ironically, there are reasons to believe that the regulatory strategy underlying the Proposal may actually instead maintain, if not worsen, the current "status quo". While fashionable, the entire agenda of the European Commission on sustainability matters (including the NFRD of 2014, SFDR of 2019, TR of 2020, CSRD of 2022, and now the CSDD proposal of 2023) largely relies on a strategy of *corporate legal engineering*, focusing on the internal functioning and governance of corporations. However, at best, this regulatory strategy implies that the pace of the corporate internalisation of negative human and environmental externalities, and thereby the transition towards a sustainable world, rests largely on corporations themselves. At worst, it might operate as a regulatory licence to corporations to continue polluting the planet and disregarding labour and human rights, albeit at the expense of a draconian corporate bureaucracy (box-ticking) and a higher legal risk (corporate litigation) – something that, by the way, will certainly make the delights of audit and legal firms. In other words, the Commission's green agenda runs the risk of becoming a "greenwashing" fiasco: in particular, corporate sustainability due diligence, from an instrument of corporate accountability and a catalyst for change, might well end up as an instrument of corporate legitimacy, perpetuating the current "status quo" .

IV. Sustainability is far too vital and urgent an issue to be left in the hands of business corporations and their inner governance structures. If sustainability is to be taken

seriously, then a radical strategic shift is necessary, moving from pure internal private mechanisms to *external and public tools*. Consider a classical and straightforward tool like a carbon tax: if corporations responsible for negative externalities to the environment where required to pay the costs of it (say, through a pollution tax), their incentives would automatically change, and thus corporate actions and strategies would automatically adjust to reduce their carbon footprint and to implement greener alternatives. While a carbon tax may not be a perfect instrument (needing to be supplemented by other sweeping public policy measures), the central point remains crucial: to avoid an eminent and irreversible environmental global collapse caused by the operations of business corporations, we must change the (external) rules of the game – by forcing *today* every company to internalize *directly* its human-social and environmental costs – rather than relying solely on changes of the (internal) rules of the players – trusting benignly that the compliance of their inner organization and governance with a menu of due diligence practices will lead *indirectly* to such cost internalisation somewhere *in the future*.

V. All things considered, the only tangible outcome of the strategy underlying the recent Proposal of Corporate Sustainability Due Diligence appears to be the inflation of a brand-new business bubble to corporations – the "*market of sustainability"*, where companies compete among each other by shouting lauder to their potential customers and investors the appealing mantra of ESG and sustainability.