



LAW SOCIETY
OF IRELAND

COM 2022/71 Corporate Sustainability Due Diligence

Joint Committee on Enterprise, Trade and Employment

7 December 2022

INTRODUCTION

Thank you for the invitation to discuss **COM 2022/71** with you today.¹

It is almost 30 years since the EU/EC, through its Fifth Environmental Action Programme², began to orient away from exclusive reliance on traditional approaches to pollution control and environmental protection in a way that started to encompass *market-based* environmental policies and instruments.

Since then, the Law Society and its members have followed this evolving approach (to integrating environmental protection into economics, business and finance) with interest to see how it would manifest *legally* in terms of *legal* obligations for businesses and companies.

In the same period, the increased emphasis on *integration* of an understanding of environmental and social impact into the activities of organisations and institutions has also been a priority for us and we commend the Committee for its early scrutiny of this important proposal which will influence, not just the activities and governance of the large companies it is initially intended to apply to but additionally - the activities of multiple other 'supply chain' and 'value chain' businesses and SMEs with which those companies contract.

As we know, it will also shape and expand the manner in which *legal* due diligence in business transactions is conducted.

1. PURPOSE AND RATIONALE UNDERLYING COM 2022/71

The Law Society supports the concept, core rationale and timing of **COM 2022/71**. The activities of large companies and transnational corporations now represent a very significant proportion of global GDP. They strongly influence the rates of natural resource use and, through their impact on environmental conditions and climate change, the ability of many millions of people worldwide to access and experience basic human rights.³

Approaches to responding to this challenge - such as Corporate Social Responsibility (CSR) and Environmental, Social and Governance (ESG) criteria and 'soft law' instruments such as the UN Guiding Principles on Business and Human Rights⁴ - will continue as important frameworks for transnational enterprises to identify, understand and respond to their environmental and human rights impacts. However, in the rapidly closing window that remains to avoid serious environmental and climate collapse, the Society considers that it is now more appropriate to progress from voluntary participation to a set of more concrete *legal* duties and obligations. Setting the parameters of that suite of requirements *at EU level*, of course, carries the clear benefit of a harmonised, standardised approach.

¹ Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937.

² "Towards Sustainability: a European Community programme of policy and action in relation to the environment and sustainable development." (17.5.1993; O.J. No. C 138/5).

³ Such as to water, clear air, food security. See U.N. Human Rights Council Resolution No. 10/4 (March 2009), one recital to which states: "Noting that climate change-related impacts have a range of implications, both direct and indirect, for the effective enjoyment of human rights including, inter alia, the right to life, the right to adequate food, the right to the highest attainable standard of health, the right to adequate housing, the right to a self-determination and human rights obligations related to access to safe drinking water and sanitation, and recalling that in no place may a people be deprived of its own means of subsistence". See also U.N. Human Rights Council Resolution No. 7/23 (March 2008) reciting that "Climate change poses an immediate and far-reaching threat to people and communities around the world and has implications for the full enjoyment of human rights".

⁴ "Guiding Principles on Business and Human Rights: Implementing the United Nations' 'Respect, Protect and Remedy' Framework"; un.ohchr.org (1.1.2012).

2. LEGAL DESIGN OF COM 2022/71

- Market-based and financially-focused legal measures, directed towards *environmental protection*, present design challenges – in particular, the need for balance between advancing environmental and social objectives, while maintaining economic and contractual freedom.
- It is not surprising, therefore, that expressions like '*where appropriate*' and '*where relevant*' feature in the draft but, where those terms are employed, they generally represent an effort to mediate between:
 - areas where large companies *do* have the opportunity to anticipate, identify and make provision against environmental and social impact; and
 - the realistic limits of traditional 'command-and-control' approaches to environmental regulation.
- Overall though, what is proposed is a series of core obligations for large companies which collectively create a clear framework to integrate an environmental and human rights *due diligence* and *awareness* into companies' corporate operations and strategies.
- The starting point is the requirement to create due diligence **policies** at corporate level which are then extended into a series of requirements designed to effect the active *implementation* of those policies and identify all *actual* or *potential* human rights and environmental impacts from company operations (together with related requirements to give meaningful corporate attention and resources to preventing, mitigating and, wherever possible, terminating those impacts).
- As you know, the draft Directive also creates clear obligations in respect of monitoring, the taking of corrective actions and a range of supporting procedural obligations related to allocating intra-company and employee responsibility.

3. MECHANISMS TO ENCOURAGE COMPLIANCE

It is important that the Sustainability Due Diligence Policies are qualitatively rigorous. The proposed Directive includes a number of mechanisms and measures to encourage regulated companies to pay continuous attention to policy accuracy and implementation - and not to regard the policies as simply a routine statutory report or corporate filing. For example:

- There is provision for *civil liability* in certain cases where large companies fail to take measures to prevent, mitigate or terminate adverse impacts.
- There are two different complaint mechanisms provided – first, the regulated companies themselves must have procedures in place to receive third party complaints about their performance relative to the various obligations imposed. Secondly, the Member States' competent authorities must have a procedure for receiving complaints from stakeholders (including civil society organisations) regarding individual companies.
- The draft Directive extends the established duty on company directors (to act in the Company's best interests) to encompass the environmental and social impacts which it is concerned with. Importantly, this emphasises that the directors' traditional fiduciary duty is no longer confined to the 'financial bottom line'.

4. INCLUSION OF 'REGULATED FINANCIAL UNDERTAKINGS'

- A feature of the proposed measure, which will contribute in an important way to its overall effectiveness, is its coverage of 'regulated financial undertakings' (in effect banks, funders, investment firms and other financial institutions).
 - This is an important advance towards greater legal certainty on the extent to which lenders are responsible for the adverse social and environmental consequences of the projects and operations which are funded through their lending decisions.
 - In the field of lending and finance, formal environmental/social impact assessment exercises are more associated with international development banks rather than private commercial banks and lenders (although the Equator Principles have become an increasingly important risk management framework to allow all financial institutions assess social and environmental risks when financing projects⁵).
 - If the finalised Directive retains much of what is currently proposed (in relation to environmental and human rights due diligence obligations *on lenders*), it has the potential to be very progressive - given the centrality of lending and finance to almost all significant infrastructure development.

5. INDIRECT EXTENSION TO REGULATED COMPANIES' BUSINESS PARTNERS

In places, the draft Directive strongly incentivises directly regulated (large) companies to build the obligations, risk-sharing and cooperation (necessary to assist them in discharging their obligations under the measure) into their contractual relationships with business and trading partners.

This is significant in a number of ways which include:

- It carries the potential to influence the activities, policies and strategies of many entities outside the large corporations to which it initially applies.
- In business-to-business due diligence (e.g. in company acquisitions and mergers) compliance with the direct and indirect obligations of the Directive will feature strongly; and
- From a legal *practice* perspective, business and corporate lawyers, will engage with this measure increasingly into the future; representing a further integration of environmental law and business law; and it is proposed that the European Commission will provide model contractual clauses to assist businesses to contract and risk share around obligations and compliance under the Directive.

6. EXTRATERRITORIAL EFFECT OF COM 2022/71

- It is welcome that the measure builds in an element of 'extra-territorial effect', by expecting the prior impact analysis and due diligence to extend to any human rights and environmental risks and impacts occurring *outside EU territory*.

⁵ See <https://equator-principles.com>

- For a range of socio-political, geographic, and historical reasons, some of the most pressing environmental and natural resource threats (and related human rights' pressures) are located *outside* EU territory.
- There are ways in which the draft Directive seeks to ensure that the extra-territorial impacts of EU-based companies do not escape scrutiny or inclusion in the due diligence policies and reporting obligations. For example:
 - the €150m and €40m turnover thresholds (that determine the application of many of the measures' obligations) refer to *'net worldwide turnover'*; and
 - impacts from the operations of a company's *'subsidiaries'* are required to be part of the environmental and human rights impact analysis; as are, in many cases, the impacts of activities of *'established business relationships'* in the value chain.
- While references to *'worldwide turnover'*; *'subsidiaries'* and *'established business relationships'* suggests an intention that the reporting/due diligence obligations *do* extend to covering extra-territorial (non-EU) areas, there are other expressions and obligations that would - if employed - strengthen that impression further (such as *'group-affiliated companies'*) and the requirement to publish *consolidated group policies and reports*). These would further enhance the scope for the draft Directive to capture reporting obligations in respect of environment and human rights' impacts outside the EU.

7. TRANSPOSITION

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In its current form, transposing the Directive into Irish law (likely by Statutory Instrument) should not present undue difficulty as its structure means that many of the obligations which are currently placed on the *Member States* can – relatively easily - be replicated and imposed on *regulated entities*.

8. ENFORCEMENT AND OVERSIGHT IN IRELAND

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It will be important to ensure that the Irish 'supervisory authority' (i.e., competent authority) has the necessary expertise to fulfil its obligations.

A number of the most important provisions are concerned with requiring competent authorities to identify breaches of companies' obligations to document human rights and environmental risks, and breaches of obligations on effective prevention, mitigation and corrective action in those fields.

This appears to demand expertise and experience within the competent authority - not just in general corporate governance, supervision and auditing but also - in the field of human rights.

As such, how our competent authority will be staffed, resourced and equipped *expertise-wise* is an important factor to consider and to now begin to plan for.

9. REVIEWING THE EFFECTIVENESS OF COM 2022/71

The draft Directive, while otherwise detailed, could include enhanced review provisions.

- The Commission's review of its effectiveness is currently proposed for 7 years after the coming into force of the Directive (i.e. 5 years after the transposition deadline).
- The imperative for urgent environmental action strongly suggests to us that there should be an earlier stocktake of all necessary factors so that any necessary enhancements can be identified and implemented.
- The current draft of the Directive does not appear to include a requirement to keep a Company's *initial* corporate due diligence policy *periodically updated*; neither does there appear to be any consideration as to which factors should activate or trigger a review/update of a regulated company's Sustainability Due Diligence Policy (perhaps a company re-organisation; a major merger or acquisition; a business asset transfer or a change of process, operation, or location?).
- We would suggest that these matters are given further consideration.

CONCLUSION

We hope that our observations are of assistance to the Committee's consideration of this important measure.

I will be glad to take questions on any aspect of our submissions and thank you for your time this morning.

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