

# LARGE COMPANIES SAVING PEOPLE AND THE PLANET – REFLECTIONS ON THE PERSONAL SCOPE OF THE APPLICATION OF THE CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE \*

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## ABSTRACT

*On 23 February 2022, the European Commission adopted a proposal for a Directive on corporate sustainability due diligence (hereinafter: CSDD). It aims to foster sustainable and responsible corporate behavior throughout global value chains. Companies will be required to identify and, where necessary, prevent, end, or mitigate adverse impacts of their activities on human rights (e.g., child labor, exploitation of workers) and on the environment (e.g. pollution and biodiversity loss). The CSDD would apply both to the EU and non-EU companies reaching certain thresholds in terms of the number of employees and amount of net turnover, with minor exemptions when the non-EU companies are concerned. Lower thresholds apply if the EU companies are doing business in the high-risk sectors, while the higher apply if the companies are operating in the non-high risk sector. To comply with new due diligence rules, companies would be required to check whether their operations are aligned with human rights and environmental law conventions listed in the Annex of the CSDD, as well as the operation of its subsidiaries and all suppliers upstream*

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and downstream in the value chain – with whom they have “established business relationship”. Given the fact that the new set of duties is comprehensive and their non-compliance triggers the company’s liability, the paper aims to compare these boundaries of the personal scope of the CSDD with criteria prescribed in similar national laws of the member states as well as to question defensive tactics of the target companies.

**KEYWORDS:** corporate sustainability, global value chains, supply chains, human rights, environmental law, due diligence, the personal scope of the application, corporate sustainability due diligence directive, defensive tactics

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## 1. INTRODUCTION

The Rana Plaza tragedy of 2013, in which 1,135 workers from supplier factories of European and North American apparel multinationals died when their unsafe building collapsed, has highlighted the need for regulation that requires companies to take responsibility for practices along the supply chain. These and other outrageous working conditions and labor practices such as the abuse of child labor, migrant workers, and forced labor in many sectors, as well as irreparable environmental damage resulting from corporate activities, are among the reasons for calling for EU legislation requiring companies to act responsibly.

In a May 4, 2018, Report on sustainable finance,<sup>1</sup> the European Parliament called for the introduction of a mandatory due diligence framework based on the 2017 OECD Guidelines for Responsible Business Conduct<sup>2</sup> and the French Corporate Duty of Vigilance Law (hereinafter *Loi de vigilance*).<sup>3</sup> This request followed the mandate given by the European Commission in its Action Plan on Financing Sustainable Growth of March 8, 2018,<sup>4</sup> to address the same issue.

To address corporate social responsibility (CSR) issues, legislators initially tended toward disclosure. Initially, voluntary CSR disclosure regimes became

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<sup>1</sup> European Parliament, Report on sustainable finance, Report - A8-0164/2018, 4 May 2018, [[https://www.europarl.europa.eu/doceo/document/A-8-2018-0164\\_EN.html](https://www.europarl.europa.eu/doceo/document/A-8-2018-0164_EN.html)], accessed on 2/11/2022.

<sup>2</sup> OECD Due Diligence Guidance for Responsible Business Conduct, [<https://www.oecd.org/investment/due-diligence-guidance-for-responsible-business-conduct.htm>], accessed on 03/10/2022.

<sup>3</sup> Loi n° 399/2017 du 23 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d’ordre, (JORF n° 0074 du 28 mars 2017).

<sup>4</sup> European Commission, Communication from the Commission Action Plan: Financing Sustainable Growth, COM(2018) 97 final, [<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018DC0097>], accessed on 02/11/2022.

mandatory for large companies with the adoption of the Non-Financial Reporting Directive (NFRD) in 2014, which mandates the disclosure of non-financial and diversity information by large EU public-interest entities.<sup>5</sup> In 2017, the NFRD was supplemented by non-binding guidelines<sup>6</sup> and the latest guidelines on reporting climate-related corporate information.<sup>7</sup> As announced in the Green Deal for Europe,<sup>8</sup> the NFRD is currently under review as part of the strategy to strengthen the basis for sustainable investment.<sup>9</sup> In addition, the European Green Deal's ambition that „sustainability should be further embedded into the corporate governance framework“<sup>10</sup> is being pursued as part of the European Commission's Sustainable Corporate Governance Initiative.<sup>11</sup>

In January 2020, the European Commission launched the process to create a mandatory due diligence framework with a Study on due diligence requirements through the supply chain.<sup>12</sup> This Study was based on the French *Loi*

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<sup>5</sup> 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, (OJ L 330, 15/11/2014). The NFRD applies to large “public-interest entities” (i.e. EU companies listed on a regulated market in the EU; listed or nonlisted credit institutions, insurance companies or other entities designated as such by Member States) with an average number of employees exceeding 500 and to public-interest entities that are parent companies of a large group with an average number of employees in exceeding 500 on a consolidated basis.

<sup>6</sup> Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information), (OJ C 215, 05/07/2017).

<sup>7</sup> Communication from the Commission – Guidelines on non-financial reporting: Supplement on reporting climate-related information, (OJ C 209, 20/06/2019).

<sup>8</sup> European Commission, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, The European Green Deal, COM(2019) 640 final, 2019, [[https://eur-lex.europa.eu/resource.html?uri=cellar:b828d165-1c22-11ea-8c1f-01aa75ed71a1.0002.02/DOC\\_1&format=PDF](https://eur-lex.europa.eu/resource.html?uri=cellar:b828d165-1c22-11ea-8c1f-01aa75ed71a1.0002.02/DOC_1&format=PDF)], accessed on 28/10/2022.

<sup>9</sup> The EU Commission put forward its proposal for a reform of the NFRD in April 2021. Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, (COM(2021) 189 final). Now proposed to be called the Corporate Sustainability Reporting Directive, including disclosure requirements for due diligence on sustainability issues and a proposal for European Sustainability Reporting Standards and assurance standards for sustainability reporting.

<sup>10</sup> European Commission, The European Green Deal, *op. cit.*

<sup>11</sup> European Commission, Sustainable Corporate Governance, [[https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporategovernance\\_en](https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporategovernance_en)], accessed on 10/11/2022.

<sup>12</sup> European Commission, Directorate-General for Justice and Consumers, Torres-Cortés, F., Salinier, C., Deringer, H. *et al.*: *Study on due diligence requirements through the supply chain*:

*de vigilance*. It concluded that voluntary regulations across Europe have not changed the way companies carry out their corporate governance responsibilities. As a result, the European Commission announced in April 2020 that new corporate legislation would be introduced for mandatory human rights and environmental due diligence.<sup>13</sup> The rationale for supporting mandatory due diligence duty at the EU level “includes a higher level of implementation, access to remedies, but also a leveling of the playing field, a single harmonized standard and legal certainty”.<sup>14</sup> In July 2020, the European Commission published the report “Study on Directors’ Duties and Sustainable Corporate Governance”.<sup>15</sup> The report was criticized by academics and business associations<sup>16</sup> and twice rejected by the European Commission’s Regulatory Scrutiny Board (RSB). The RSB stressed that there was no need to regulate directors’ duties in addition to due diligence requirements and that companies in the EU already sufficiently consider sustainability aspects in their business strategies.<sup>17</sup>

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*final report*, Publications Office, 2020, [<https://data.europa.eu/doi/10.2838/39830>], accessed on 30/10/2022.

<sup>13</sup> EU Commission publishes legislative proposal on corporate accountability, [<https://www.business-humanrights.org/en/latest-news/eu-commissioner-for-justice-commits-to-legislation-on-mandatory-due-diligence-for-companies/>], accessed on 02/11/2022.

<sup>14</sup> European Commission, Directorate-General for Justice and Consumers, Torres-Cortés, F., Salinier, C., Deringer, H., *et al.*, *op. cit.*, p. 154.

<sup>15</sup> European Commission, Directorate-General for Justice and Consumers: *Study on directors’ duties and sustainable corporate governance: final report*, Publications Office, 2020, [<https://data.europa.eu/doi/10.2838/472901>], accessed on 28/10/2022.

<sup>16</sup> The main criticisms concerned the incorrect definition of the problem (conflating problems of time horizon (short-termism) with externalities and distributional issues), insufficient evidence of an increase in short-termism (use of gross payouts to shareholders instead of net payouts (gross payouts minus equity issuances)), biased use of the existing literature, and poorly thought-out reform proposals (the effectiveness of the proposed measures and the cost of their implementation). See in Roe, M. J.; Spamann, H.; Fried, J. M.; Wang, C. C. Y.: *The European Commission’s Sustainable Corporate Governance Report: A Critique*, European Corporate Governance Institute - Law Working Paper 553/2020, Harvard Public Law Working Paper No. 20-30, Yale Journal on Regulation Bulletin, October 2020, [<https://ssrn.com/abstract=3711652>], accessed on 10/09/2022, p. 134-135. Some legal scholars argued for the use of additional procedural regulatory instruments (disclosure or consultation requirements). See in Möslin, F.; Sørensen, K. E.: *Sustainable Corporate Governance: A Way Forward*, Nordic & European Company Law Working Paper No. 21-03, European Corporate Governance Institute - Law Working Paper No. 583/2021, January 2021, [<https://ssrn.com/abstract=3761711>], accessed on 10/09/2022, p. 5-9.

<sup>17</sup> Regulatory Scrutiny Board Opinion on Proposal for a Directive of the European Parliament and of the Council on Sustainable Corporate Due Diligence and amending Directive (EU) 2019/1937, (SEC (2022) 95, 26/11/2021).

Taking into account the results of a public consultation that ended in February 2021 and the non-binding recommendations of the European Parliament in March 2021,<sup>18</sup> the European Commission published a new legislative Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence<sup>19</sup> (hereinafter CSDD) on February 23, 2022, which is described as “a real game changer in the way companies operate their business activities throughout their global supply chain” or “a watershed moment for human rights and the environment”.<sup>20</sup> The CSDD aims to introduce mandatory and harmonized rules on sustainability due diligence in the European Economic Area, as voluntary measures by companies are insufficient and companies face regulatory chaos in their cross-border activities.<sup>21</sup>

An important issue is the identification of the companies that fall within the scope of the CSDD, as the personal scope of the regulatory regimes already adopted in the EU Member States varies and may do so even more in the future. In addition, other Member States may decide not to legislate in this area. As highlighted in the explanatory memorandum to the proposal for the CSDD this may result in certain companies with cross-border value chains already being subject to different requirements and likely to be subject to even more different requirements depending on where their registered office is located. At the same time, depending on how they structure their business in the

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<sup>18</sup> European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)), (OJ C 474, 24.11.2021.). The Resolution has been criticised for not detailing the standards that companies are expected to meet, for the broad range of measures that companies are required to take to comply with the standards, and for the practical problems that can arise if the standards are not met. Davies, P.; Emmenegger, S.; Ferrarini, G. *et. al.*: *Commentary: The European Parliament's Draft Directive on Corporate Due Diligence and Corporate Accountability*, European Corporate Governance Institute, April 2021, [<https://ecgi.global/news/commentary-european-parliament's-draft-directive-corporate-due-diligence-and-corporate>], accessed on 12/10/2022, p. 6

<sup>19</sup> 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, 2022/0051(COD), 23/2/2022).

<sup>20</sup> Pietrancosta, A.: *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, European Corporate Governance Institute - Law Working Paper No. 639/2022, [<http://dx.doi.org/10.2139/ssrn.4083398>], accessed on 13/10/2022, footnotes 35 and 36, where he quotes Didier Reynders, Commissioner for Justice and Richard Gardiner of Global Witness, in Aoife White, Alberto Nardelli, and Stephanie Bodoni, *Unethical Firms Risk Massive Bills in EU Supply-Chain Crackdown*, Bloomberg, 21 February 2022.

<sup>21</sup> As explained in the Explanatory memorandum of 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/2022/71 final, 2022/0051(COD), 23/02/2022), p. 1-3.

internal market, some companies could be simultaneously subject to two or more different national legal frameworks dealing with sustainable corporate governance. This could pose some problems in practice, in particular the issue of legal certainty, compliance difficulties, duplicative requirements, and even incompatible parallel legal requirements. Conversely, some companies may fall outside the scope of a national legal framework simply because they do not have relevant links under national law to the jurisdiction of the Member State where the due diligence requirements apply, giving them an advantage over their competitors.<sup>22</sup>

To prevent and remove such obstacles the proposed CSDD would apply to both EU and non-EU companies that meet certain thresholds in terms of the number of employees and amount of net turnover. In addition, respective companies should consider not only their operations but also those of their subsidiaries and suppliers. As stated in the impact assessment, the comparative advantage of the CSDD proposal in respect of traditional EU environmental law is its application “to value chains outside the EU, where up to 80-90% of the environmental harm may occur”.<sup>23</sup> An indirect business relationship means that the value chain extends beyond a contractual relationship within a group company.<sup>24</sup> However, this threatens legal certainty, makes it more difficult for EU companies to do business, and reduces their competitiveness.

As mentioned above, some national legislators have already addressed the issue of due diligence in the supply chain before the adoption of the proposal for the CSDD. The French legislator, which served as a model for the European legislator in regulating these issues, did so in 2017 with the adoption of the *Loi de vigilance*. German legislators regulated these issues with the Law on Corporate Due Diligence in Supply Chains<sup>25</sup> whose provisions will apply from January 1, 2023. Although the aims are similar, the German and French laws have some important differences in terms of the substance and scope of the due diligence requirement.

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<sup>22</sup> Explanatory memorandum of 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/2022/71 final, 2022/0051(COD), 23/02/2022), p. 11.

<sup>23</sup> Commission Staff Working Document, Impact Assessment Report, Accompanying the document 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 - SEC(2022) 95 final - SWD(2022) 38 final - SWD(2022) 39 final - SWD(2022) 43 final), p. 2.

<sup>24</sup> Davies, P.; Emmenegger, S.; Ferrarini, G. *et. al.*: *Commentary: The European Parliament’s Draft Directive on Corporate Due Diligence and Corporate Accountability*, *op. cit.*, p. 11-12.

<sup>25</sup> Gesetz über die unternehmerischen Sorgfaltspflichten zur Vermeidung von Menschenrechtsverletzungen in Lieferketten (Lieferkettensorgfaltspflichtengesetz – LkSG) vom 16. Juli 2021, (BGBl. I, Nr. 46, 2959 ff).

In the paper, the authors provide an overview of the provisions of the CSDD and the approach of French and German legislators in regulating corporate due diligence in the supply chain. The central part of the paper is the analysis of the personal scope of application of the CSDD, the French *Loi de vigilance*, and the German *Lieferkettensorgfaltspflichtengesetz*. The authors compare the personal scope of application of the CSDD with the criteria prescribed in French and German law and point out open questions in their application.

## **2. OVERVIEW OF THE PROPOSAL FOR A DIRECTIVE ON CORPORATE SUSTAINABILITY DUE DILIGENCE**

As mentioned earlier, the CSDD aims to promote sustainable and responsible corporate behavior throughout global value chains. Companies will be required to identify and, where necessary, prevent, end, or mitigate adverse impacts of their activities on human rights (e.g., child labor, exploitation of workers) and the environment (e.g., pollution and biodiversity loss). These new rules will provide legal certainty and a level playing field for enterprises as well as greater transparency for consumers and investors. The proposal introduces a corporate sustainability due diligence duty to address negative impacts on human rights and the environment at the EU level.

The CSDD lists applicable international conventions and guidelines for the protection of human rights and the environment. However, these international legal instruments set imprecise standards that need to be translated into binding rules for companies. The relevant standards must be determined by the CSDD, and another problem arises from their application in the process of drafting a due diligence policy and implementing it in a company. A company encounters the interests of various stakeholders who will be consulted in the process of creating a due diligence policy. However, the different interests of stakeholders will create conflicts and make it difficult for the company to create an appropriate due diligence policy.<sup>26</sup> The due diligence policy has to be carried out across the whole value chain of the company and not just to the company's or group's own operations. The company must take into account the possible infringements of its suppliers, customers, and subsidiaries.

The new due diligence rules apply to large EU companies and companies in defined impact sectors, as well as non-EU companies active in the EU (Arti-

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<sup>26</sup> Davies, P.; Emmenegger, S.; Ferrarini, G. *et. al.*: *Commentary: The European Parliament's Draft Directive on Corporate Due Diligence and Corporate Accountability*, *op. cit.*, p. 7-11. Roe, M. J.; Spamann, H.; Fried, J. M.; Wang, C. C. Y.: *The European Commission's Sustainable Corporate Governance Report: A Critique*, *op. cit.*, p. 151.

cle 2 of the CSDD). Small and medium-sized enterprises (SMEs) do not fall directly within the scope of this proposal. Concerning non-EU companies,<sup>27</sup> the question arises as to how compliance with the CSDD should be supervised and which national administrative authority should carry out this supervision. These companies may withdraw from the EU market and transfer their operations to other markets or decide not to enter the market. In this way, the positive impact of the CSDD on third countries is mitigated.<sup>28</sup>

The CSDD applies to the company's own operations, its subsidiaries, and their value chains (direct and indirect established business relationships) (Article 3 of the CSDD). It is pointed out by some authors that the application of the CSDD should be limited only to direct business partners of the company.<sup>29</sup> To comply with the corporate due diligence duty, companies need to integrate due diligence into their policies and monitor, prevent, eliminate or minimize actual or potential adverse impacts on human rights and the environment (Articles 4-8 of the CSDD).<sup>30</sup> They must establish and maintain a complaints procedure, monitor the effectiveness of the due diligence policy and taken measures, and publicly communicate on due diligence (Articles 9-11 of the CSDD). Large EU companies need to have the plan to ensure that their business strategy is consistent with limiting global warming to 1.5 °C in line with the Paris Agreement (Article 15 of the CSDD). The mandatory climate plan has already become obsolete due to the war between Russia and Ukraine and the existing energy crisis.<sup>31</sup>

National administrative authorities appointed by Member States will be responsible for supervising these new rules and may impose fines in case of non-compliance (Articles 17-20 of the CSDD). In addition, injured parties will

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<sup>27</sup> Non-EU companies must appoint an authorized representative (natural or legal person) who is established or has a residence in one of the Member States in which they operate. The competent authorities of the Member States shall address the authorized representative on all matters necessary for the receipt, compliance and implementation of legal acts issued in relation to the Directive (Article 16 of the CSDD).

<sup>28</sup> Davies, P.; Emmenegger, S.; Ferrarini, G. *et. al.*: *Commentary: The European Parliament's Draft Directive on Corporate Due Diligence and Corporate Accountability*, *op. cit.*, p. 19-20.

<sup>29</sup> Thomsen, S.; *Comments on the Corporate Sustainability Due Diligence Directive*, Online Policy Workshop - European Commission Directive on Corporate Sustainability Due Diligence, Stockholm School of Economics, European Corporate Governance Institute, 28-29 March 2022, [[https://ecgi.global/sites/default/files/steen\\_thomsen\\_sustainability\\_due\\_dilligence\\_ccgi\\_29\\_march.pdf](https://ecgi.global/sites/default/files/steen_thomsen_sustainability_due_dilligence_ccgi_29_march.pdf)], accessed on 10/10/2022, p. 8.

<sup>30</sup> It will be difficult for companies to identify actual and potential adverse impacts, especially with regard to indirect business partners. See in Davies, P.; Emmenegger, S.; Ferrarini, G. *et. al.*: *Commentary: The European Parliament's Draft Directive on Corporate Due Diligence and Corporate Accountability*, *op. cit.*, p. 12-14.

<sup>31</sup> Thomsen, S.; *Comments on the Corporate Sustainability Due Diligence Directive*, *op. cit.*, p. 11.



be able to take legal action for damages that could have been avoided with appropriate due diligence measures (Article 22 of the CSDD). An open question is which litigation regime shall be applied by the Member States.<sup>32</sup>

The CSDD introduces the duty of directors to establish and monitor the implementation of due diligence and to integrate it into corporate strategy. In fulfilling their duty to act in the best interests of the company, directors must consider the impact of their decisions on human rights, climate change, and the environment (Article 25 of the CSDD). The existing rules on directors' duties are sufficient for this purpose.<sup>33</sup> When directors receive variable remuneration, they should be incentivized to contribute to climate change mitigation by reference to the corporate plan (Article 15 of the CSDD). Such incentive schemes will be complex in practice.<sup>34</sup>

### 3. PERSONAL SCOPE OF THE APPLICATION OF THE CSDD

One of the key issues for the effectiveness of the proposed regulatory framework is the issue of the personal scope of application of the CSDD. Under the adopted provisions, the new due diligence rules will apply to both EU and non-EU companies.<sup>35</sup> EU companies (companies incorporated under the laws

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<sup>32</sup> It is not clear to what extent Member States will apply their own liability rules or whether they will have to amend these rules in accordance with the CSDD. See in Thomsen, S.; *Comments on the Corporate Sustainability Due Diligence Directive*, *op. cit.*, p. 16. Roe, M. J.; Spamann, H.; Fried, J. M.; Wang, C. C. Y.: *The European Commission's Sustainable Corporate Governance Report: A Critique*, *op. cit.*, p. 152-153. Davies, P.: *Briefing: Due diligence in supply chains and net zero plans*, Online Policy Workshop - European Commission Directive on Corporate Sustainability Due Diligence, Stockholm School of Economics, European Corporate Governance Institute, 28-29 March 2022, [<https://ecgi.global/sites/default/files/Presentation%3A%20Paul%20Davies.pdf>], accessed on 10/10/2022, p. 13-15.

<sup>33</sup> They already take these aspects into account when making decisions. See in Thomsen, S.; *Comments on the Corporate Sustainability Due Diligence Directive*, *op. cit.*, p. 8. Roe, M. J.; Spamann, H.; Fried, J. M.; Wang, C. C. Y., *op. cit.*, p. 145-146.

<sup>34</sup> It is proposed to adopt fixed remuneration for non-executive directors and long-term incentives for executive directors. The introduction of non-financial environmental, social and governance (ESG) metrics into remuneration schemes is problematic. These metrics need to be meaningful and measurable. A meaningful metric must be one that directors can directly influence and that is not already covered by other regulations. See in Thomsen, S.; *Comments on the Corporate Sustainability Due Diligence Directive*, *op. cit.*, p. 12., Roe, M. J.; Spamann, H.; Fried, J. M.; Wang, C. C. Y.: *The European Commission's Sustainable Corporate Governance Report: A Critique*, *op. cit.*, p. 149-150.

<sup>35</sup> The personal scope has been significantly reduced following the reflections triggered by the Board's comments on the description of the problem, in particular in relation to SMEs, and on the proportionality of the preferred option.

of a Member State) that fall within the scope of the CSDD can be divided into two groups.<sup>36</sup> The first group includes companies with an average of more than 500 employees that generated a worldwide net turnover of more than EUR 150 million in the last financial year for which annual financial statements were prepared. The second group includes companies that do not meet the thresholds of the first group, but have an average of more than 250 employees and generated a worldwide net turnover of more than EUR 40 million in the last financial year for which annual financial statements were prepared, provided that at least 50 % of these net turnover was generated in one or more of the defined high-impact sectors.<sup>37</sup> For these companies, the rules apply two years later than for the first group. In contrast to the 2011 United Nations Guiding Principles (UNGPs)<sup>38</sup> and the OECD Guidelines for Multinational Enterprises, which recommend their application to all companies, “regardless of their size, sector, location, ownership or structure”,<sup>39</sup> even if this means modulating the intensity of the corresponding obligations to take these factors into account, the European proposal follows the more restrictive French model, particularly in terms of legal forms or company size, while setting the social thresholds much lower.<sup>40</sup>

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<sup>36</sup> As regards the EU companies, the Member State competent to regulate matters covered in the CSDD shall be the Member State in which the company has its registered office. (Art. 2 par. 4 of the CSDD)

<sup>37</sup> The following sectors are covered: (i) the manufacture of textiles, leather and related products (including footwear), and the wholesale trade of textiles, clothing and footwear; (ii) agriculture, forestry, fisheries (including aquaculture), the manufacture of food products, and the wholesale trade of agricultural raw materials, live animals, wood, food, and beverages; (iii) the extraction of mineral resources regardless from where they are extracted (including crude petroleum, natural gas, coal, lignite, metals and metal ores, as well as all other, non-metallic minerals and quarry products), the manufacture of basic metal products, other non-metallic mineral products and fabricated metal products (except machinery and equipment), and the wholesale trade of mineral resources, basic and intermediate mineral products (including metals and metal ores, construction materials, fuels, chemicals and other intermediate products). Methven O’Brien, C.; Martin-Ortega, O.: *Sustainable corporate governance: Submission to Consultation on European Commission’s proposal for a Directive on corporate sustainability due diligence COM(2022)71 final*, [https://www.researchgate.net/publication/360845316\_Sustainable\_corporate\_governance\_Submission\_to\_Consultation\_on\_European\_Commission’s\_proposal\_for\_a\_Directive\_on\_corporate\_sustainability\_due\_diligence\_COM202271\_final], accessed on 28/10/2022, p. 7, note that some sectors that pose a high risk to vulnerable rights-holders in Europe, such as social care, healthcare, hospitality and entertainment, construction, technology, cleaning, and beyond, are unlikely to be covered by this approach.

<sup>38</sup> The United Nations Guiding Principles on Business and Human Rights, 2011, [https://www.ohchr.org/sites/default/files/Documents/Publications/GuidingPrinciplesBusinessHR\_EN.pdf], accessed on 15/10/2022.

<sup>39</sup> See Principle 14 of the UNGPs on Business and Human Rights, *op. cit.*

<sup>40</sup> Pietrancosta, A.: *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, *op. cit.*, p. 25.

In terms of company form, the proposed legal framework for EU companies mainly includes joint stock companies and LLCs,<sup>41</sup> except for regulated financial entities.<sup>42</sup>

Regarding the calculation of the number of employees, the CSDD provides that the number of part-time employees is calculated on a full-time equivalent basis. Temporary agency workers are included in the calculation of the number of employees in the same way as if they had been employed directly by the company for the same period.

For non-EU companies (companies incorporated under the laws of a third country), the CSDD applies if the company meets one of the following conditions: a) generating a net turnover of more than EUR 150 million in the Union in the financial year preceding the last financial year, or b) generating a net turnover of more than EUR 40 million but not more than EUR 150 million in the Union in the financial year preceding the last financial year, provided that at least 50 % of its net worldwide turnover was generated in one or more of the listed high-impact sectors.

The criteria for defining the group of EU and non-EU companies covered are not the same. For non-EU companies, a net turnover threshold is used, but all turnover must be generated in the Union. The adopted solution is justified by the fact that it ensures a sufficient territorial link to the EU. EU companies, in turn, must have a prescribed net turnover generated worldwide and must also meet an employee criterion. The adopted solution is justified by the fact that there is no method for calculating the number of employees of third-country companies. Moreover, experience shows that in the absence of a common definition of the term “employees”, the number of employees (worldwide) is diffi-

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<sup>41</sup> As in France and in contrast to the German Due Diligence Act.

<sup>42</sup> Art. 3(a) of the CSDD provides a long list of legal persons or regulated entities that fall within the definition of company: (i) legal persons constituted as one of the legal forms listed in Annex I to Directive 2013/34/EU of the European Parliament and of the Council (joint-stock corporations and LLCs); (ii) legal persons constituted in accordance with the law of a third country in a form comparable to those listed in Annex I and II of that Directive; (iii) legal persons constituted as one of the legal forms listed in Annex II to Directive 2013/34/EU composed entirely of undertakings organised in one of the legal forms falling within points (i) and (ii); and (iv) regulated financial undertakings, regardless of its legal forms (credit institutions, investment firms, alternative investment fund managers (AIFMs), alternative investment fund (AIFs), undertakings for collective investment in transferable securities (UCITS), insurance and reinsurance undertakings, institutions for occupational retirement provision, pension institutions, central counterparties, central securities depositories, securitisation special purpose entities, payment institutions, electronic money institutions, crowdfunding service providers, crypto-asset service providers...).

cult to calculate, which complicates the identification of third-country companies falling within the scope and prevents effective enforcement.<sup>43</sup>

In contrast to French and German law, the wording of the CSDD seems to indicate that the thresholds for the number of employees and net turnover should be calculated individually for each company, as defined by Art. 3(a) of the CSDD, and not at the group level. This raises the question of the possibility of manipulating the thresholds by splitting the activities among structures.<sup>44</sup>

Based on the estimations of the Commission the CSDD will cover about 13,000 EU companies<sup>45</sup> and about 4,000 third-country companies.<sup>46</sup>

It should be noted that the review clause explicitly refers to the personal scope of the CSDD, which should be reviewed in light of practical experience with the application of the legislation.

#### **4. THE APPROACH OF THE FRENCH AND GERMAN LEGISLATORS IN REGULATION OF CORPORATE DUE DILIGENCE IN THE SUPPLY CHAIN**

With the adoption of the *Loi de vigilance*<sup>47</sup> in 2017, France was one of the first countries to regulate human rights and environmental due diligence in the supply chain. As mentioned above, the French model is an important milestone as it largely inspired the European Commission in its proposed directive on CSDD.

*Loi de vigilance* was the result of a four-year struggle by French Non-Governmental Organizations (NGOs) and trade unions and three deputies of the French Congress. The adoption of the Law was enabled by a combination of conditions: public outrage over the 2013 “Rana Plaza” tragedy, in which a textile factory in Bangladesh closely linked to French companies collapsed; France’s national political culture (widespread expectation of state intervention; antiglobalization sentiment); a center-left government under the previous

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<sup>43</sup> Explanatory memorandum of 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/2022/71 final, 2022/0051(COD), 23/02/2022), p. 15.

<sup>44</sup> Pietrancosta, A.: *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, *op. cit.*, p. 25.

<sup>45</sup> 9,400 companies in the first group and 3,400 companies in the second group.

<sup>46</sup> 2,600 companies in the first group and 1,400 companies in the second group.

<sup>47</sup> Loi n° 399/2017 du 23 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d’ordre, (JORF n° 0074 du 28 mars 2017).

president Hollande; and the appointment in 2016 of a minister of economy and industry who endorsed the Law.<sup>48</sup>

The *Loi de vigilance* went through four readings in the French National Assembly and three in the Senate, where the Law was weakened.<sup>49</sup> A comparison between the original legislative proposal submitted to the presidency of the National Assembly in November 2013 and the Law passed in March 2017 shows significant differences in the scope of application. The original proposal addressed all companies established in France and not just only those exceeding a certain number of employees. After the *Loi de vigilance* was passed, right-wing and liberal deputies from both chambers appealed to the Constitutional Council, arguing that the Law was unconstitutional and affected companies' freedom of trade and commerce. The Council decided that the *Loi de vigilance* was generally compatible with the Constitution, but objected to the possibility of a civil fine of up to thirty million euros.<sup>50</sup>

Many companies subject to the *Loi de vigilance* published their first vigilance plans in 2018 and reported on the implementation of these plans in 2019 and 2020. French civil society organizations have strongly criticized the first generation of vigilance plans, stating that the plans are very short and “do not allow us to understand exactly what risks have been identified by companies ... let alone how companies are responding to those risks”.<sup>51</sup> In addition, the plans address risks in very general terms, with no mention of specific subsidiaries, controlled entities, or production facilities.<sup>52</sup>

In addition to the *Loi de vigilance*, the PACTE Law<sup>53</sup> for the growth and transformation of companies, approved in May 2019, also goes in the same direction

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<sup>48</sup> Schilling-Vacaflor, A.: *Putting the French Duty of Vigilance Law in Context: Towards Corporate Accountability for Human Rights Violations in the Global South?*, Human Rights Review, (22) 2021, [<https://doi.org/10.1007/s12142-020-00607-9>], p. 115.

<sup>49</sup> Rapport à Monsieur le Ministre de l'économie et des finances, Evaluation de la mise en œuvre de la loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre, January 2020, [[https://www.economie.gouv.fr/files/files/directions\\_services/cge/devoirs-vigilances-entreprises.pdf](https://www.economie.gouv.fr/files/files/directions_services/cge/devoirs-vigilances-entreprises.pdf)], accessed on 05/10/2022, p. 14.

<sup>50</sup> Schilling-Vacaflor, A.: *Putting the French Duty of Vigilance Law in Context: Towards Corporate Accountability for Human Rights Violations in the Global South?*, *op. cit.*, p. 116.

<sup>51</sup> Sherpa, Vigilance Plans Reference Guidance, [[https://www.asso-sherpa.org/wp-content/uploads/2019/02/Sherpa\\_VPRG\\_EN\\_WEB-ilovepdf-compressed.pdf](https://www.asso-sherpa.org/wp-content/uploads/2019/02/Sherpa_VPRG_EN_WEB-ilovepdf-compressed.pdf)] , accessed on 02/11/2022.

<sup>52</sup> Schilling-Vacaflor, A.: *Putting the French Duty of Vigilance Law in Context: Towards Corporate Accountability for Human Rights Violations in the Global South?*, *op. cit.*, p. 117.

<sup>53</sup> Loi n° 2019-486 du 22 mai 2019 relative à la croissance et la transformation des entreprises, (JORF n° 0119 du 23 mai 2019).

by introducing the consideration of social and environmental aspects in corporate governance (Article 169 amending Article 1833 of the Civil Code).<sup>54</sup> However, these provisions have long been included in the Commercial Code, at least for listed companies since 2002 and for large companies since 2011, which must indicate in their management report (Article L225-102-1) “how the company takes into account the social and environmental consequences of its activities”.<sup>55</sup>

The French *Loi de vigilance* is the law usually cited as the model for the German Law on Corporate Due Diligence in Supply Chains (*Gesetz über die unternehmerischen Sorgfaltspflichten zur Vermeidung von Menschenrechtsverletzungen in Lieferketten*; hereinafter: *Lieferkettensorgfaltspflichtengesetz*, LkSG), which was passed by the German Bundestag on June 11, 2021. It was followed by the approval of the Bundesrat on June 25, 2021.<sup>56</sup> The LkSG will enter into force on January 1, 2023.

The basis for the LkSG was the National Action Plan on Business and Human Rights (*Nationaler Aktionsplan Wirtschaft und Menschenrechte*, NAP), which was adopted in 2016.<sup>57</sup> However, a multi-year company survey conducted by the German government (NAP monitoring) revealed that currently only about one-fifth of all German-based companies with more than 500 employees sufficiently comply with their human rights due diligence obligations along their supply chains.<sup>58</sup> This shows that a voluntary commitment is not sufficient.

The NAP, the LkSG, and the *Law of vigilance* are based on the United Nations Guiding Principles on Business and Human Rights,<sup>59</sup> which are among the

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<sup>54</sup> The PACTE Law is applicable to all companies registered in France, regardless of their form or size.

<sup>55</sup> The PACTE law also included two optional provisions that introduced two new concepts into French law: the “raison d’être” company’s fundamental reason for being, that a company may define in its bylaws, to state its principles or core values and the “société à mission” (“mission-driven company”). See more in Pietrancosta, A.: *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, *op. cit.*, p. 3.

<sup>56</sup> The LkSG was published in the Federal Law Gazette on July 22, 2021. *Gesetz über die unternehmerischen Sorgfaltspflichten zur Vermeidung von Menschenrechtsverletzungen in Lieferketten* (Lieferkettensorgfaltspflichtengesetz – LkSG) vom 16. Juli 2021, (BGBl. I, Nr. 46, 2959 ff).

<sup>57</sup> Nationaler Aktionsplan Umsetzung der VN-Leitprinzipien für Wirtschaft und Menschenrechte 2016–2020, [<https://www.auswaertiges-amt.de/blob/297434/8d6ab-29982767d5a31d2e85464461565/nap-wirtschaft-menschenrechte-data.pdf>], accessed on 21/06/2022.

<sup>58</sup> Monitoring des Nationalen Aktionsplans Wirtschaft und Menschenrechte: Ergebnisse der zweiten Erhebung, [<https://www.auswaertiges-amt.de/de/aussenpolitik/themen/aussenwirtschaft/wirtschaft-und-menschenrechte/ergebnisse-2-umfrage-nap/2374446>], accessed on 21/06/2022.

<sup>59</sup> The United Nations Guiding Principles on Business and Human Rights, *op. cit.*

most important internationally recognized standards of corporate responsibility for human rights.

The French *Loi de vigilance* and the German LkSG differ significantly in terms of personal scope, substantive requirements, and enforcement regime.

The *Loi de vigilance* consists essentially of two provisions incorporated into the French Commercial Code (Articles L. 225-102-4 and L. 225-102-5 of the Commercial Code). They require French companies to prepare, publish and implement a vigilance plan (*plan de vigilance*), which must include reasonable vigilance measures to detect and prevent violations of human rights and fundamental freedoms, serious bodily injury, environmental damage, or health risks. They also provide for a range of sanctions in the event that the monitoring plan is prepared, published, or implemented properly or at all. Thus, the duty of vigilance goes well beyond due diligence. Due diligence may be limited to simply identifying risks, typically once a year, while the duty of vigilance requires companies to identify and monitor risks and respond to them through ongoing risk mitigation and prevention measures.<sup>60</sup> In addition, companies are required to publish the plan and the report on its effective implementation, and to include both in the company's annual management report.<sup>61</sup>

One of the core elements of the due diligence obligations under the German LkSG is the establishment of a risk management system to identify, prevent or minimize the risks of human rights violations and environmental damage. The LkSG specifies the necessary preventive and remedial measures makes complaint procedures mandatory and requires regular reports. The LkSG contains an exhaustive list of eleven internationally recognized human rights conventions.<sup>62</sup>

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<sup>60</sup> Rühl, G.: *Towards a German Supply Chain Act? Comments from a Choice of Law and a Comparative Perspective*, European Yearbook of International Economic Law, 11 (2021), [<https://ssrn.com/abstract=3708196>], p. 12. Clerc, C.: *The French 'Duty of Vigilance' Law: Lessons for an EU Directive on Due Diligence in Multinational Supply Chains*, ETUI Policy Brief, European Economic, Employment and Social Policy, 1 (2021), [<https://www.etui.org/publications/french-duty-vigilance-law>], accessed on 22/06/2022, p. 3.

<sup>61</sup> According to the wording of the *Loi de vigilance*, it has been suggested that this obligation should be understood as requiring that the plan and the report on its effective implementation be published (in the sense of made available to the public) and included in the company's annual management report. Savourey, E.: *France Country Report*, EC Study on due diligence requirements through the supply chain, Part III: Country Reports, January 2020, [<https://op.europa.eu/en/publication-detail/-/publication/0268dfcf-4c85-11ea-b8b7-01aa75ed71a1/languageen/format-PDF/source-search>], accessed on 11/10/2022, p. 64.

<sup>62</sup> These include, in particular, the prohibition of child labour, slavery and forced labour, the disregard of occupational health and safety regulations, the withholding of an adequate wage, the disregard of the right to form trade unions or workers' representations, the denial of access to food and water, and the unlawful appropriation of land and livelihoods.

With this new legislation, Germany and France join the group of countries such as the United Kingdom, the Netherlands,<sup>63</sup> Austria, Belgium, Denmark, Finland, Italy, Luxembourg, and Norway,<sup>64</sup> which have already enacted similar regulations.<sup>65</sup>

However, the LkSG and the *Loi de vigilance* have also attracted much criticism, not only from opponents of mandatory human rights due diligence obligations but also from proponents. While they welcome the creation of a legally binding framework to better protect human rights in global supply chains, they argue that the scope of the LkSG<sup>66</sup> and the *Loi de vigilance*<sup>67</sup> is too limited.

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<sup>63</sup> Wet van 24 oktober 2019 houdende de invoering van een zorgplicht ter voorkoming van de levering van goederen en diensten die met behulp van kinderarbeid tot stand zijn gekomen, (Staatsblad 2019, 401).

<sup>64</sup> Lov om virksomheters åpenhet og arbeid med grunnleggende menneskerettigheter og anstendige arbeidsforhold (åpenhetsloven) (Act relating to enterprises' transparency and work on fundamental human rights and decent working conditions), (LOV-2021-06-18-99).

<sup>65</sup> Annex 8 of the Impact Assessment accompanying proposal for CSDD provides a detailed overview on Member State/EEA laws and initiatives. [[https://eur-lex.europa.eu/resource.html?uri=cellar:c851d397-9584-11ec-b4e4-01aa75ed71a1.0001.02/DOC\\_2&format=PDF](https://eur-lex.europa.eu/resource.html?uri=cellar:c851d397-9584-11ec-b4e4-01aa75ed71a1.0001.02/DOC_2&format=PDF)], accessed on 20/11/2022.

<sup>66</sup> Initiative Lieferkettengesetz, *What the new Supply Chain Act delivers – and what it doesn't*, [[https://www.germanwatch.org/sites/default/files/Initiative-Lieferkettengesetz\\_Analysis\\_What-the-new-supply-chain-act-delivers.pdf](https://www.germanwatch.org/sites/default/files/Initiative-Lieferkettengesetz_Analysis_What-the-new-supply-chain-act-delivers.pdf)], accessed on 18/06/2022, p. 5, points out that “the number of companies covered is too small. Instead of focusing on all large companies with more than 250 employees, as well as SMEs in sectors with particular human rights risks, the Law only covers companies with more than 3,000 employees (from 2024: with more than 1,000 employees). But even, SMEs can have significant negative impacts on human rights and environmental issues if they operate in a high-risk sector.” Rühl, G.: Cross-border Protection of Human Rights: The 2021 German Supply Chain Due Diligence Act, in: Borg-Barthet, Živković *et. al.* (eds): *Gedächtnisschrift in honor of Jonathan Fitchen*, 2022, [<https://ssrn.com/abstract=4024604>], accessed on 15/06/2022, p. 4, points out that „given the personal scope, the reach of the due diligence obligations is further limited because the Supply Chain Act does not apply to all companies incorporated or active in Germany... Even though the scope of application will be extended to companies with at least 1,000 employees as of January 1, 2024, only a small fraction of companies based in Germany will have to comply with the already limited requirements of the Supply Chain Act.“

<sup>67</sup> Clerc, C.: *The French 'Duty of Vigilance' Law: Lessons for an EU Directive on Due Diligence in Multinational Supply Chains*, *op. cit.*, p. 3, where he suggests that a much simplified version of the duty should apply to SMEs, that the scope of the Law should include all forms of companies, and that the Law should not be limited to companies whose legal seats are based in France but should also include foreign companies doing business in France.



#### 4.1. THE PERSONAL SCOPE OF APPLICATION OF THE FRENCH LOI DE VIGILANCE AND GERMAN LKSG

To determine the personal scope of the application, it is crucial to establish the criteria according to which certain companies fall within the scope of the legal framework. These may be the company's registered office, its legal form, the activities that are the subject of the company's business and the number of employees, defining the term "employees", or which categories of employees are to be taken into account when calculating the threshold. In addition, net turnover may be one of the criteria for determining the personal scope.

Under the French *Loi de vigilance*, companies must meet a total of three criteria to be bound by the adopted legal framework. First, they must have their registered office (*siège social*) in France. However, this condition does not derive from the wording of Article L. 225-102-4 I of the Commercial Code but was confirmed by the French Constitutional Council immediately after the adoption of the *Loi de vigilance*.<sup>68</sup> It should also be emphasized that the *Loi de vigilance* applies to any company with its registered office in France, whether or not it is a subsidiary of a parent company with its registered office abroad, provided that it meets the criteria relating to the corporate form and the number of employees.<sup>69</sup>

Second, they must be organized in a specific corporate form, namely a public limited company (*société anonyme*), a partnership limited by shares (*société en commandite par actions*), or a European Company (*société européenne*). The *Loi de vigilance* does not list these types of companies. They can only be identified by the position of the provisions of the *Loi de vigilance* in the French Commercial Code.<sup>70</sup> An open question was whether the Law applies to the *société par actions simplifiée* ('SAS'), as this form has become increasingly popular in France due to its flexible structure. Immediately after the adoption of the *Loi de vigilance*, different positions were taken.<sup>71</sup> Both the French gov-

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<sup>68</sup> See Conseil constitutionnel, Décision no 2017-750 DC du 23 mars 2017, [<https://www.conseil-constitutionnel.fr/decision/2017/2017750DC.htm>], para. 3.

<sup>69</sup> Brabant, S.; Savourey, E.: *Scope of the Law on the Corporate Duty of Vigilance, Companies Subject to the Vigilance Obligations*, Revue Internationale de la Compliance et de l'Éthique des Affaires – Supplément à la Semaine Juridique Entreprise et Affaires (N° 50) 2017, [<https://media.business-humanrights.org/media/documents/cc551474b8206d6a7b9c6a-92c2a3fb280c881139.pdf>], accessed on 10/10/2022, p. 2. Savourey, E.: *France Country Report*, *op. cit.*, p. 63.

<sup>70</sup> Savourey, E.; Brabant, S.: *The French Law on the Duty of Vigilance: Theoretical and Practical Challenges Since its Adoption*, Business and Human Rights Journal, (6) 2021, p. 144.

<sup>71</sup> See more in Savourey, E.; Brabant, S.: *The French Law on the Duty of Vigilance: Theoretical and Practical Challenges Since its Adoption*, *op. cit.*, p. 144.

ernment<sup>72</sup> and the General Council of Economy<sup>73</sup> took the position that this form of company is also included in the scope of the application.

The third requirement is that, at the end of two consecutive financial years, 1) at least 5,000 employees work for the company and its direct and indirect French-registered subsidiaries, or 2) at least 10,000 employees work for the company and its direct and indirect French or foreign subsidiaries. Therefore, French subsidiaries of foreign groups may fall within the scope of the Law through their own French and foreign subsidiaries and thus be required to prepare a vigilance plan for their value chains. An exception exists for companies controlled by a company already covered (Art. L. 233-3 of the Commercial Code).<sup>74</sup>

Thus, the companies to be taken into account for determining the scope of the Law are, on the one hand, companies registered in France with at least 5,000 employees in the company itself and its subsidiaries, but only in the subsidiaries with their registered office in France, or, on the other hand, companies registered in France with at least 10,000 employees, including in their subsidiaries with their registered office abroad.

For the calculation of employees (*salariés*) in France, in the absence of specific rules, the usual social rules apply, i.e., the calculation of average employees in full-time equivalents for the year in question, applying the rules provided for in the French *Code du travail* (Articles L1111-2 and L1111-3).<sup>75</sup> For employees abroad, the calculation is more uncertain.

It should be noted that the scope of the French *Loi de vigilance* is not determined based on a turnover threshold. Moreover, in French law, it is important

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<sup>72</sup> French Government, Observations du Gouvernement sur la loi relative au devoir de vigilance des sociétés

mères et des entreprises donneuses d'ordre (28 March 2017), [<https://www.legifrance.gouv.fr/jorf/id/JORFTEXT000034290672/>], accessed on 12/10/2022.

<sup>73</sup> Rapport à Monsieur le Ministre de l'économie et des finances, Evaluation de la mise en œuvre de la loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre, *op. cit.*, p. 19.

<sup>74</sup> Article L. 225-102-4, I, paragraph 2 of the Commercial Code provides that: "subsidiaries or controlled companies which exceed the thresholds set out in the first paragraph are deemed to satisfy the obligations provided in this article when the company which controls them, within the meaning of article L. 233-3, establishes and implements a vigilance plan related to the activity of the company and all of the subsidiaries or companies which it controls".

<sup>75</sup> Brabant, S.; Savourey, E.: *Scope of the Law on the Corporate Duty of Vigilance, Companies Subject to the Vigilance Obligations*, *op. cit.*, p. 2, noting that "... the phrase "employees" (*salariés*) seems to exclude certain forms of employment in particular persons working for the company and its subsidiaries, in France and abroad, under a status other than salaried staff."

to distinguish between the companies that fall within the scope of the *Loi de vigilance* and are thus subject to the vigilance obligation and the companies that fall under the vigilance plan to be drawn up by the companies that fall within the scope of the *Loi de vigilance*.

The Report to the Minister of Economy and Finance on the evaluation of the *Loi de vigilance*, published in February 2020, emphasizes that it is impossible to draw up a reliable list of companies covered by the Law. As for the number of companies, a wide and non-definitive range between 200 and 250 can be given.<sup>76</sup> This number is quite low compared to the thousands of European and non-European companies potentially covered by the CSDD.

The General Council of Economy proposed to amend the scope of the *Loi de vigilance* to make it more precise and to simplify the identification of the companies covered by the Law. Among other things, it proposed extending the scope of application of the *Loi de vigilance* to additional types of companies and to include turnover and/or balance sheet thresholds in addition to the existing thresholds for the number of employees.<sup>77</sup>

Possibly influenced by the European approach, a French parliamentary committee proposed in February 2022 to redefine the scope of the French law by lowering the thresholds for employees and introducing an alternative trigger linked to turnover.<sup>78</sup>

From 2023, the LkSG will apply to companies that have their head office, principal place of business, administrative headquarters, registered office or branch office, and 3,000 employees in Germany. From 2024, it will also apply

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<sup>76</sup> Rapport à Monsieur le Ministre de l'économie et des finances, Evaluation de la mise en œuvre de la loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre, *op. cit.*, p. 19. Rühl, G.: *Towards a German Supply Chain Act? Comments from a Choice of Law and a Comparative Perspective*, *op. cit.*, p. 14, concluded that only 237 companies would have to comply with the requirements of the new French law. In 2020, the NGO Group (Sherpa and CCFD Terre Solidaire) published a report identifying 265 companies that they determined as falling within the scope of the Law. Out of those, the report indicated that 27% of the companies had not published a vigilance plan (including high-profile companies from French or foreign groups). Sherpa and CCFD Terre Solidaire, *Le radar du devoir de vigilance, identifier les entreprises soumises à la loi*, June 2021, [<https://vigilance-plan.org/wp-content/uploads/2021/07/2021-07-05-Radar-DDV-Rapport-2021-1.pdf>], accessed on 05/10/2022.

<sup>77</sup> Rapport à Monsieur le Ministre de l'économie et des finances, Evaluation de la mise en œuvre de la loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre, *op. cit.*, p. 58.

<sup>78</sup> Rapport à Monsieur le Ministre de l'économie et des finances, Evaluation de la mise en œuvre de la loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre, *op. cit.*, p. 57.

to companies with 1,000 or more employees in Germany. It is estimated that 2,900 German companies and 1,900 foreign companies with a branch in Germany will be covered by the LkSG.<sup>79</sup>

The LkSG applies to foreign companies with a German branch. This provision aims to prevent these companies from relocating their registered offices abroad. They cannot transfer their registered office and principal place of business abroad or convert their German location into a branch office<sup>80</sup> but must leave Germany completely.<sup>81</sup> Foreign companies with German branch offices and German companies are subject to the LkSG in their total value chain, not just in Germany.

The LkSG applies to companies in all industries, regardless of their legal form. The term company in the LkSG is a generic term for all forms of enterprises. It is neutral with regard to legal form. It does not matter whether the company is a limited liability company or a listed company. The LkSG does not impose any restrictions here, as the existence of human rights or environmental risks does not depend on the legal form chosen for a company.<sup>82</sup>

Economically active, publicly owned private-law legal entities fall within the scope of the other requirements of Section 1 LkSG are met. Public corporations that perform certain administrative tasks of a public body according to territorial criteria, on the other hand, do not fall within the scope of application as long as they are not economically active in markets. This must be examined on a case-by-case basis. In principle, hospitals also fall within the scope of the LkSG, provided they meet the employee threshold, are economically active in markets, offer healthcare services in return for payment, bear the associated financial risks, and are purchasers (e.g. of medical equipment). They must also

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<sup>79</sup> Grabosch, R.: *The Supply Chain Due Diligence Act, Germany sets new standards to protect human rights*, [<http://library.fes.de/pdf-files/iez/18755.pdf>], accessed on 21/06/2022., p. 5.

<sup>80</sup> According to Section 13d of the German Commercial Code (Handelsgesetzbuch – HGB), a branch office is an independent entity, not just a representative office, warehouse or sales outlet, in which essential corporate functions such as human resources, finance and accounting, purchasing and sales are performed at least in part. A branch office can easily be converted into a subsidiary. As long as it is not converted, it is not an independent legal entity, cannot enter into contracts with others and is not subject to the legal requirements of the LkSG. Foreign companies conduct their business in Germany through their branch office. They must make their branch offices public and register in the German Commercial Register. See more in Grabosch, R.: *The Supply Chain Due Diligence Act, Germany sets new standards to protect human rights*, *op. cit.*, p. 5.

<sup>81</sup> Grabosch, R.: *The Supply Chain Due Diligence Act, Germany sets new standards to protect human rights*, *op. cit.*, p. 5.

<sup>82</sup> See more at Federal Ministry of Labour and Social Affairs, Business and Human Rights, Supply Chain Act, Frequently Asked Questions, [<https://www.csr-in-deutschland.de/EN/Business-Human-Rights/Supply-Chain-Act/FAQ/faq.html#doc3a956f-cc-c35e-4655-a96a-6a39a1a0a2cfbodyText1>], accessed on 20/06/2022.

exercise due diligence.<sup>83</sup> According to the LkSG's explanatory memorandum, financial services are also covered by the LkSG, since investing a larger sum or granting a larger loan triggers further production processes.

According to the German LkSG, the *per capita* principle is used to determine the number of employees. In addition, the general definition of the term “employee” in Section 611a of the German Civil Code (*Bürgerliches Gesetzbuch – BGB*) applies. However, the BGB does not distinguish between part-time and full-time employees. It must be examined whether the respective employee is of significance for the relevant size of the company. This is the case if the duration of employment is at least six months.<sup>84</sup>

According to Section 1 para. 1 sentence 1 no. 2 LkSG, only the employees “normally/usually” (*in der Regel*) employed are relevant. The number of “normally/usually” employed workers is to be determined by way of a retrospective and a forecast of future personnel development. The length of the reference period depends on the individual case but should generally be based on the business year.<sup>85</sup> In assessing the future development of the workforce, the circumstances characterizing the development of the business in the individual case must be determined. This includes, in particular, concrete change decisions by the employer, e.g. whether a continuous reduction of the workforce to

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<sup>83</sup> Federal Ministry of Labour and Social Affairs, Business and Human Rights, Supply Chain Act, Frequently Asked Questions, *op. cit.*

<sup>84</sup> In addition to regular full-time and part-time employees, the following employees are included in full (*per capita*): employees posted abroad, temporary agency workers if the period of employment with the user company exceeds six months, senior staff, the following special groups of employees: employees on probation, home workers, dependent commercial agents, employees participating in a short-time work scheme, or employees absent due to maternity leave. The number of employees therefore also includes employees of foreign subsidiaries working in Germany. The following are not included: *temporary agency workers if the duration of the assignment to the user company does not exceed six months, freelancers and self-employed persons, board members of legal entities in general, shareholders of legal entities (exception: any person who is both a non-managing shareholder and an employee of the company), all persons whose primary obligations under the employment contract were suspended for more than six months during one business year (e. g. early retirees, persons in the passive phase of partial retirement, employees on parental leave), civil servants and soldiers (these are employment relationships under public law), trainees, retrainees within the meaning of the German Vocational Training Act (Berufsbildungsgesetz – BBiG), interns and persons undergoing journalistic training.* See more at Federal Ministry of Labour and Social Affairs, Business and Human Rights, Supply Chain Act, Frequently Asked Questions, [<https://www.csr-in-deutschland.de/EN/Business-Human-Rights/Supply-Chain-Act/FAQ/faq.html;jsessionid=51E30CD8D538C077B4018324F81ECDC5.delivery2-replication#doc3a956fcc-c35e-4655-a96a-6a39a1a0a2cfbodyText3>], accessed on 18/10/2022.

<sup>85</sup> Germany's New Supply Chain Act – Part 4 of 4 – FAQs, [<https://www.jdsupra.com/legal-news/germany-s-new-supply-chain-act-part-4-8086307/>], accessed on 18/06/2022.

a certain level is planned for the future. It is necessary that this decision has been made by the responsible body of the company and that there is nothing significant to prevent the implementation of the decision.

## **5. EXPANDING THE SCOPE OF APPLICATION ON SUBSIDIARIES / SUPPLIERS / ESTABLISHED BUSINESS RELATIONSHIPS**

Due diligence applies not only to a company's own operations but also to the actions of a contractor and the actions of other subcontractors and suppliers. This means that a company's responsibility no longer ends at its factory gate but applies along the entire supply chain. Therefore, the proposed legal solutions are also relevant for companies that are not directly affected. They may be indirectly affected, for example as suppliers or subcontractors of a company.

According to the CSDD, companies should take appropriate steps to establish and conduct due diligence on their own operations, their subsidiaries, and their established direct and indirect business relationships along their value chains. To determine which business relationships are covered, it is important to define the terms subsidiary, value chain, business relationship, and established business relationship.

According to the CSDD, a subsidiary is a legal entity through which the activities of a "controlled undertaking" within the meaning of Article 2(1)(f) of Directive 2004/109/EC of the European Parliament and the Council are carried out. The CSDD thus explicitly states that a subsidiary must be a legal entity without prescribing its legal form. It must therefore be assumed that it can have any legal form. There is also no indication that the subsidiary must have its registered office in the EU. It is also clear that subsidiaries are included whether they are part of the parent company's value chain. However, for the identification of subsidiaries, the CSDD<sup>86</sup> refers to the definition of „controlled undertaking“ in the Transparency Directive. This provision includes entities in which (i) the parent company holds a majority of the voting rights, (ii) the parent company is a shareholder and has the right to appoint or remove a majority of the members of the administrative, management, or supervisory body, (iii) the parent company is a shareholder and controls a majority of the voting rights of the subsidiary through an agreement entered into with other shareholders of the subsidiary, and (iv) over which the parent company has the power to exercise, or does exercise, dominant influence or control.<sup>87</sup>

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<sup>86</sup> Article 3(d) of the CSDD.

<sup>87</sup> Zubović, A.: *Stjecanje glasačke kontrole nad uvrštenim društvom (doktorska disertacija)*, Zagreb, 2012., p. 6. Čulinović-Herc, E.; Jurić, D.: *Disclosure of Beneficial Ownership – From*

One of the open questions to which the CSDD does not provide a clear answer is whether indirect subsidiaries are included, e.g., a subsidiary controlled by a subsidiary of the company. These are covered by the definition in the Transparency Directive as per the addition of Article 2(1)(f) to the definition in Article 2(2). However, as the CSDD does not refer to the article in the Transparency Directive, indirect subsidiaries do not appear to be covered.<sup>88</sup> Indirectly controlled subsidiaries may, however, be part of the company's value chain and thus included in the due diligence process. This could lead to companies changing their group structure and operations to avoid the obligations imposed on them if the proposed CSDD is adopted.

The approach adopted in the CSDD has several shortcomings. First, if a group is headed by a parent company that has neither the number of employees nor the turnover required by the CSDD, the parent company is not required to conduct due diligence on its subsidiaries. However, if a subsidiary has the size required by the CSDD, that subsidiary must conduct due diligence in its operations and in its subsidiaries. Other subsidiaries owned by the parent company may escape this obligation.<sup>89</sup> In addition, groups can speculate and thus avoid applying the CSDD, or at least avoid applying it to those group companies most likely to be associated with human rights and environmental risks.

According to Article 3(1)(g) of the CSDD, the term “value chain” means the activities related to the production of goods or the provision of services by a company, including the development of the product or service and the use and disposal of the product, as well as the related activities of upstream and downstream established business relationships of the company. Concerning regulated financial undertakings as defined in Article 3(1)(a)(iv) of the CSDD, the “value chain” about the provision of these specific services includes only the activities of the clients receiving the such loan, credit, and other financial services and of other companies belonging to the same group whose activities are linked to the contract in question. The value chain of such regulated financial undertakings does not include the SMEs that receive loans, credits, financing, insurance, or reinsurance from such entities. The doctrine takes the position that, despite the scope of the definition, only B-to-B relationships should be covered.<sup>90</sup>

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*EU Major Shareholdings Directive to EU new Transparency Directive – What needs to be changed in Croatian Securities Markets Act?*, 5th International Conference „Economic integrations, competition and cooperation“, Rijeka, 2005., p. 12-18

<sup>88</sup> Sørensen, K. E.: *Corporate Sustainability Due Diligence in Groups of Companies*, Nordic & European Company Law Working Paper No. 22-02, [<https://ssrn.com/abstract=4141862>], accessed on 03/11/2022, p. 5.

<sup>89</sup> *Ibid.*, p. 2.

<sup>90</sup> Pietrancosta, A.: *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, *op. cit.*, p. 33.

It is also important to distinguish between the terms „subsidiary“ and “value chain” because, although some associated undertakings and joint ventures are not considered subsidiaries, they may still be part of the company’s value chain if they engage in activities related to the company’s operations.<sup>91</sup> The main requirement for determining the value chain is the existence of an “established business relationship”. According to Art. 3(1)(f) of the CSDD, “established business relationship” means a direct or indirect business relationship which is, or which is expected to be lasting, in a view of its intensity or duration and which does not represent a negligible or merely ancillary part of the value chain. This differs from the UNGPs, which specify that human rights and environmental due diligence are carried out throughout the value chain, and do not include a restriction to “established business relationships”.

For purposes of the CSDD business relationship means a relationship with a 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. Therefore, Article 3(e)(i) of the CSDD states that a business relationship is part of the value chain even if it is not related to the company’s business operations if the company either has a commercial agreement with the company or provides financing or insurance. Although the latter provision is primarily aimed at financial institutions, it could be interpreted to include non-financial institutions that invest in affiliated companies or joint ventures.

The French *Loi de vigilance* extends due diligence obligations to third parties (Article L. 225-102-4 I para. 3 of the Commercial Code). Companies covered by the *Loi de vigilance* must ensure that controlled companies (*sociétés directement ou indirectement contrôlées*), subcontractors (*sous-traitants*) and suppliers (*fournisseurs*) do the same. The vigilance plan must therefore cover: the activities of the companies that fall within the scope of the *Loi de vigilance* and are therefore responsible for drawing up the vigilance plan, the activities of the companies that are directly or indirectly controlled by the company falling within the scope of the *Loi de vigilance* as defined in Article 233-16-II of the Commercial Code, and the activities of subcontractors or suppliers with whom an established commercial relationship exists if these activities are related to that relationship. These provisions raise a number of questions, as the key terms used to determine the value chain are not explicitly and clearly defined in national legislation.

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<sup>91</sup> Sørensen, K. E.: *Corporate Sustainability Due Diligence in Groups of Companies*, op. cit., p. 4.



In French law, subsidiaries or controlled companies are explicitly mentioned in three provisions about the fulfilment of vigilance obligations. The first provision establishes the personal scope of the *Loi de vigilance*. Therefore, in order to determine whether a company falls within the scope of the Law, its “direct and indirect subsidiaries” must be identified. This identification of subsidiaries is thus an essential prerequisite for counting employees. However, the definition of the scope of the Law does not clearly define the term “subsidiary“. In the absence of clarification by the *Loi de vigilance*, the question arises whether this means that the definition of a “subsidiary” under Article L. 233-1 of the Commercial Code applies. According to this article, a subsidiary is a company in which more than half of the company capital is held by another company. The doctrine also seems to favor of a positive answer to this question.<sup>92</sup> Both the OECD Guidelines and the UNGPs favor a broad interpretation of the concept of control.<sup>93</sup>

Another provision that explicitly mentions both subsidiaries and controlled companies is the one that provides for exceptions to the vigilance obligation. The term “controlled companies”, which is not mentioned in determining the scope of the Law, appears in the scope of the exemptions. They are defined by reference to Article L. 233-3 of the Commercial Code which contains various hypotheses of control, including joint control and the presumption of control. Thus, the question is whether this exemption mechanism is mandatory or optional for subsidiaries and controlled companies. What happens if the parent company or its subsidiary wants the subsidiary to be bound by the vigilance obligations? The use of the words “are deemed” by the legislator could appear to introduce a non-rebuttable presumption (*présomption irréfragable*) resulting from the parent company’s compliance with the vigilance obligations for its subsidiaries and controlled companies. This mechanism does not seem to be a flexible and adaptable tool and is likely to promote the management/distribution of responsibility within groups. In any case, when applying this exemption, it is important that the parent company ensures the application of procedures and indicators in the exempt companies when preparing its vigilance plan and its subsequent effective implementation. In this way, the effective implementation of the plan is ensured.<sup>94</sup>

The third provision prescribes the content of the vigilance plan, which must include, among other things, appropriate due diligence measures arising from the activities of the controlled companies. The controlled companies whose

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<sup>92</sup> Brabant, S.; Savourey, E.: *Scope of the Law on the Corporate Duty of Vigilance, Companies Subject to the Vigilance Obligations, op. cit.*, p. 6.

<sup>93</sup> See Principle 14 of the UNGPs on Business and Human Rights, *op. cit.*

<sup>94</sup> Brabant, S.; Savourey, E.: *Scope of the Law on the Corporate Duty of Vigilance, Companies Subject to the Vigilance Obligations, op. cit.*, p. 8.

activities must be included in the vigilance plan are determined by reference to Article L. 233-16-II of the Commercial Code, as outlined in the *Loi de vigilance*. The control provided for in Article L. 233-16-II is classified as “exclusive control” because it allows the company to exercise decision-making power, in particular over the financial and business policies of another company. This control may be exercised in different ways: legal control, when it results from the direct or indirect holding of the majority of the voting rights in another company (art. L. 233-16, II, 1° of the Commercial Code), *de facto* control, when it results from the right to appoint, for two consecutive financial years, the majority of the members of the administrative, management or supervisory bodies of another company (art. L. 233-16, II, 2° of the Commercial Code) or contractual control (art. L. 233-16, II, 3° of the Commercial Code), when a company is contractually or legally entitled to „use or determine the use of the assets of another company in the same manner“ as it controls its assets. This concept of exclusive control significantly expands the number of companies to be included in the scope of the plan, especially since such control may be direct or indirect, as specified in the *Loi de vigilance*.<sup>95</sup>

In France, subsidiaries appear to be covered even if they are not part of the parent company’s supply chain since they do not contribute to the production of the parent company’s goods and provision of its services. Unlike French law, which uses an impersonal formulation, the European reference to the value chain of „the company “<sup>96</sup> may raise doubts as to whether the value chain of the subsidiaries should be included.<sup>97</sup>

The term subcontractor is defined in the Law of December 31, 1975, as follows „subcontracting is the operation whereby a contractor entrusts to another person, called a subcontractor (*sous-traitant*), through a subcontractee (*sous-traité*) and under the latter’s responsibility, the execution of all or part of the service or procurement contract concluded with the principal (*maître de l’ou-*

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<sup>95</sup> The European Commission emphasizes that the French *Loi de vigilance* “is also innovative because it recognizes that control can be exercised through contracts”. Commission Staff Working Document, Impact Assessment Report, Accompanying the document Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, (SWD(2022) 42 final, Brussels, 23/02/2022), p. 25. See more in Pietrancosta, A.: *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, op. cit., p. 26.

<sup>96</sup> Art. 1(1) of the CSDD.

<sup>97</sup> This kind of ambiguity reflects the difficulties of the transition from soft law to hard law. It is significant that the 2011 UNGPs make no reference to “subsidiaries” and are explained only in terms of “business enterprises”. See more in Pietrancosta, A.: *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, op. cit., p. 22-23.

vrage)<sup>98</sup> While the concept of a subcontractor is defined and relatively limited, the opposite is assumed for the concept of a supplier.<sup>99</sup>

However, the French *Loi de vigilance* does not require companies to avoid all human rights violations, but only those that are considered serious (*atteintes graves*). Moreover, human rights due diligence do not extend to all companies in the supply chain. According to Article L. 225-102-4 I (3) of the Commercial Code, only subcontractors, and suppliers with whom there is an established commercial relationship (*relation commerciale établie*) must be included in the vigilance plan if this relationship is related to the activities in question.<sup>100</sup> The term “established commercial relationship” refers to former Article L 442-6-I of the Commercial Code (now Article L. 442-1-II of the Commercial Code), which prohibits the sudden termination of commercial relationships when they are established.<sup>101</sup> The question of whether there is an established commercial relationship is subject to case law, which takes into account the duration, frequency, and growth of the commercial relationship. Indirect relationships with subcontractors and suppliers up to an undetermined rank in the usual supply chain must also be considered. Because the *Loi de vigilance* does not clearly specify the entities for which the existence of an established commercial relationship must be determined, the question arises as to whether and to what extent this type of relationship is limited to first-tier partners or whether it also extends to cascading partners, potentially extending the duty of vigilance to millions of companies.<sup>102</sup> In answering this question, the doctrine refers to the

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<sup>98</sup> Loi n° 75-1334 du 31 décembre 1975 relative à la sous-traitance, (JORF du 3 janvier 1976), art. 1. See more in Brabant S.; Michon, C.; Savourey E.: *The Vigilance Plan - Cornerstone of the Law on the Corporate Duty of Vigilance*, Revue Internationale de la Compliance et de l'Éthique des Affaires – Supplément à la Semaine Juridique Entreprise et Affaires (N° 50) 2017, [<https://media.business-humanrights.org/media/documents/ba571b7294311e42b3605af7cc4eeaad149c33b2.pdf>], accessed on 06/10/2022.

<sup>99</sup> See more in Brabant S.; Michon, C.; Savourey E.: *The Vigilance Plan - Cornerstone of the Law on the Corporate Duty of Vigilance*, *op. cit.*

<sup>100</sup> The concept of „established commercial relationship“ was preferred to the originally proposed concept of „decisive influence“ on the activities of subcontractors or suppliers for reasons of effectiveness and clarity. Pietrancosta, A.: *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, *op. cit.*, p. 26. Rühl, G.: *Towards a German Supply Chain Act? Comments from a Choice of Law and a Comparative Perspective*, *op. cit.*, p. 14. Brabant S.; Michon, C.; Savourey E.: *The Vigilance Plan - Cornerstone of the Law on the Corporate Duty of Vigilance*, *op. cit.*

<sup>101</sup> For the purposes of French law, an “established commercial relationship” is a regular and stable relationship, with or without a contract, which has a certain volume of business and can reasonably be expected to last.

<sup>102</sup> Pietrancosta, A.: *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, *op. cit.*, p. 27.

Constitutional Court's decision confirming that subcontractors and suppliers fall within the ambit of the vigilance plan if they have an established commercial relationship with the parent company or the companies it controls.<sup>103</sup>

The supply chain as defined in Section 2(5) of the LkSG refers to all products and services of a company. It includes all steps in Germany and abroad that are necessary for the manufacture of products and the provision of services, beginning with the extraction of raw materials and ending with delivery to the end customer, and includes the actions of a company in its own business, the actions of direct suppliers and the actions of indirect suppliers. The due diligence obligations under Section 2(5) sentence 2 of the LkSG, therefore, extend not only to actions in the company's business area, but also to the actions of all direct and indirect suppliers, and to the entire supply chain. Thus, for the first time in German history, the LkSG introduces due diligence obligations that require companies to pay attention to what other, legally independent companies are doing. This also applies to the use of necessary services, such as the transport or temporary storage of goods. This risk assessment obligation is activated whenever the company "must expect a significantly changed or significantly expanded risk situation in the supply chain, for example, due to the introduction of new products, projects or a new business field".<sup>104</sup> Changes in business operations require an *ad hoc* review of identifiable, typical risks in the supply chain.

Own business includes all activities of the company to achieve the business objective. This includes any activity for the creation and exploitation of products and services, regardless of whether it is carried out at a location in Germany or abroad. In the case of affiliated companies, the parent company's business operations include a group company if the parent company exercises a decisive influence over the group company.<sup>105</sup>

As mentioned above, the business relationships and production methods of direct suppliers must be taken into account in addition to the company's business area. For the purposes of the LkSG, a direct supplier is a partner in a contract

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<sup>103</sup> Pietrancosta, A.: *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, *op. cit.*, p. 27., where he refers to the decision of the Constitutional Court of March 23, 2017, prec., § 11, which states that „the group of economic partners of the company subject to the obligation to draw up a plan [...] includes all the companies directly or indirectly controlled by that company, as well as all the subcontractors and suppliers with which it has an established commercial relationship, regardless of the nature of the activity of those companies, their workforce [effectifs], their economic weight or the place of establishment of their activities.“

<sup>104</sup> Section 5(4) of the LkSG.

<sup>105</sup> Section 2(6) of the LkSG.

for the supply of goods or the provision of services whose supplies are necessary for the production of the company's product or the provision and use of the relevant service.<sup>106</sup> Furthermore, if a company has factual indications that suggest a violation of human rights or environmental obligation by an indirect supplier, it must take appropriate measures without delay. An indirect supplier within the meaning of the LkSG is any company that is not a direct supplier and whose supplies are necessary for the manufacture of the company's products or the provision and use of the relevant service.<sup>107</sup> It should be emphasized, however, that these requirements of the LkSG only extend to indirect suppliers if a company gains "substantiated knowledge" of human rights violations or environmental violations at this level (Section 9(3) LkSG).<sup>108</sup> This knowledge can come from a variety of sources, such as complaints received through the complaints procedure, reports from NGOs and trade unions, or tips from government authorities.<sup>109</sup>

As a lack of regulation, it is pointed out that companies have to comply with Sections 3 et seq. of the LkSG only when manufacturing products and providing services, while other business relationships are excluded.<sup>110</sup> As a result, risks associated with suppliers responsible for ancillary services (e. g., building cleaning and office catering) can often be completely disregarded or addressed with little effort, either because there is no causal contribution (see Section 4(2) LkSG) or because the causal contribution is insignificant (see Section 5(2) LkSG). It is also emphasized that the intensity of the due diligence obligations decreases along the supply chain. In fact, they only apply to the company's own business and its relationships with its direct suppliers. Concerning indirect suppliers, companies are only required to conduct a risk analysis if they receive "substantiated knowledge" indicating the possibility of a human rights violation or environmental damage. If this is the case, companies are only required to set up the complaint mechanism required by Section 9 of the LkSG.

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<sup>106</sup> Section 2(7) of the LkSG.

<sup>107</sup> Section 2(8) of the LkSG.

<sup>108</sup> Initiative Lieferkettengesetz, *What the new Supply Chain Act delivers – and what it doesn't*, op. cit., p. 4, points out that this is one of the shortcomings of the legal framework, as this restriction is not compatible with the preventive idea of the UN Guiding Principles. Furthermore, it emphasises that it is well known that a large proportion of human rights violations occur precisely at the beginning of supply chains, i.e. in the area of indirect suppliers. In order for companies to be able to adequately prevent these, a systematic and forward-looking analysis of possible risks is required, including those that are not publicly known.

<sup>109</sup> Grabosch, R.: *The Supply Chain Due Diligence Act, Germany sets new standards to protect human rights*, op. cit., p. 5.

<sup>110</sup> Rühl, G.: *Towards a German Supply Chain Act? Comments from a Choice of Law and a Comparative Perspective*, op. cit., p. 3.

This means, in particular, that there is no obligation to establish a human rights risk management system or to conduct regular risk analyses with respect to the more distant links in the supply chain.<sup>111</sup>

With regard to affiliated companies, the German legislator has taken the position that all forms of affiliated companies as defined in Section 15 of the German Stock Corporation Act (*Aktiengesetz – AktG*) are covered by the LkSG. The parent company must count the employees of its subsidiaries, etc., if the parent company, its subsidiaries and the subsidiaries of its subsidiaries are affiliated companies within the meaning of Section 15 of the AktG. Counting is always done from “bottom to top”, i.e. the employees of the subsidiaries count for the parent company. However, the employees of the parent company are not counted for the subsidiary.<sup>112</sup>

Own business operations include not only the company itself but also affiliated companies in Germany and abroad. The prerequisite for this is that the parent company exercises a decisive influence over the other companies in the group. It must be able to exercise this influence under the applicable law. Whether a decisive influence is possible is determined by an overall consideration of the business, personnel, organizational and legal interrelationships between the subsidiary and the parent company. Indications are a large majority shareholding in the subsidiary, a group-wide compliance system, responsibility for controlling key processes in the subsidiary, a similar business area, or overlapping personnel.<sup>113</sup> Thus, if the German parent company has a decisive influence on a foreign subsidiary, it must fulfill all due diligence obligations concerning the subsidiary, regardless of whether the subsidiary operates in Germany or exports to Germany.

The group of consolidated companies of Section 1(3) of the LkSG only covers group divisions located in Germany and all possible cases are listed in section 15 of the AktG. Employees of a foreign parent company or foreign subsidiaries of a domestic parent company are not taken into account. In this context, we must distinguish between several scenarios.

The first scenario is the case where both the parent company and the subsidiary are covered by the LkSG, but there is no decisive influence of the parent

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<sup>111</sup> *Ibid.*, p. 3. Krajewski, M.; Tonstad, K.; Wohltmann, F.: *Developments in the Field Mandatory Human Rights Due Diligence in Germany and Norway: Stepping, or Striding, in the Same Direction?*, Business and Human Rights Journal, 6(3) 2021, p. 550-558.

<sup>112</sup> Federal Ministry of Labour and Social Affairs, Business and Human Rights, Supply Chain Act, Frequently Asked Questions, *op. cit.*

<sup>113</sup> Federal Ministry of Labour and Social Affairs, Business and Human Rights, Supply Chain Act, Frequently Asked Questions, [<https://www.csr-in-deutschland.de/EN/Business-Human-Rights/Supply-Chain-Act/FAQ/faq.html#doc3a956fcc-c35e-4655-a96a-6a39a1a0a2cf-bodyText1>], accessed on 20/06/2022.

company on the subsidiary. In this case, both companies must comply with the due diligence obligations for their business and supply chains. Separate implementation is to be assumed.<sup>114</sup> If the subsidiary is also a direct supplier of the parent company, then the parent company must also fulfill its due diligence obligations for direct suppliers concerning this subsidiary.

The second scenario is the case where both the parent company and the subsidiary are covered by the LkSG, but there is a decisive influence of the parent company on the subsidiary. In this case, the parent company must comply with the due diligence obligations for its business area and supply chains. This also applies to the business area and supply chains of the subsidiary. The responsibility extends to the commercial activities of the subsidiary in relation to the manufacture and exploitation of products and the provision of services. It does not matter whether a subsidiary supplies its products or services to the parent company or sells them to third parties. Depending on individual risk susceptibility, the subsidiary's risk management system may be set up in the parent company itself or the subsidiary. The subsidiary itself is also responsible for ensuring that due diligence obligations are met in its business area and supply chains.<sup>115</sup>

The third scenario is the case where only the parent company of the group, but not the subsidiary, falls within the scope of the LkSG. In this case, the parent company must fulfill the due diligence obligations for its business area and supply chains. This also applies to the business area and supply chains of a subsidiary if the parent company exercises a decisive influence over the subsidiary. In cases where the influence is not decisive, the parent company only has to review the subsidiary's risk management activities in accordance with the requirements of the LkSG if the subsidiary is a (direct) supplier of the parent company. In these cases, the subsidiary itself is not legally required to implement or report on the due diligence measures itself.<sup>116</sup>

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<sup>114</sup> Thus, both must publish their own reports under Section 10 (2) of the LkSG. Independently of this, the companies can coordinate the measures they take. For example, the subsidiaries can adopt suitable measures from the parent companies (e.g., policy statements/training, etc.) and implement them on their own responsibility. This can then be presented in the required report. Federal Ministry of Labour and Social Affairs, Business and Human Rights, Supply Chain Act, Frequently Asked Questions, *op. cit.*

<sup>115</sup> In these cases, it may be appropriate to reduce the parent company's obligations to mere monitoring obligations to the subsidiary. Another possibility is that the subsidiary must prove that the parent company has fulfilled its obligations. This depends on the structure of the group and the respective risk exposure of the parent company and its subsidiaries. Federal Ministry of Labour and Social Affairs, Business and Human Rights, Supply Chain Act, Frequently Asked Questions, *op. cit.*

<sup>116</sup> However, the German government expects companies that do not fall within the scope of the law to comply with their human rights due diligence obligations as set out in the National

The fourth scenario is the case where only the subsidiary, but not the parent company, falls within the scope of the LkSG (e.g., subsidiary of a U.S. parent company). In this case, the subsidiary must conduct due diligence for its business area and supply chains, but not for the entire group. The activities of the parent company do not have to be taken into account by the subsidiary.<sup>117</sup>

With regard to the LkSG, it is crucial that (subsidiary) companies comply with the legal requirements. This can be achieved through a uniform risk management system at the group level or through a risk management system designed by the German subsidiary itself.

## **6. EFFECTS OF THE CSDD, LOI DE VIGILANCE, AND LKSG ON SMALL AND MEDIUM-SIZED ENTERPRISES (SMES)**

The literature on the impact of due diligence regulations on SMEs shows that SME companies can be directly and indirectly affected by such measures. Many studies distinguish between the impact on SMEs that fall directly within the scope of the regulations, e.g., publicly-listed SMEs in the case of the EU's NFRD (now CSRD), and SMEs that are affected by second-round effects, e.g., small businesses that must report relevant information to corporate clients or suppliers that are directly affected by the regulation.<sup>118</sup> It is noted that there are currently about 24 million companies in the EU, of which about 80 % are limited liability companies. About 98-99 % of limited liability companies are SMEs.<sup>119</sup>

According to the CSDD, SMEs, which include microenterprises are exempt from due diligence. The chosen solution is justified by the fact that for this category of companies, the financial and administrative burden of implementing and carrying out due diligence would be relatively high, as they do not already have due diligence mechanisms in place, do not possess the know-how, and do not have specialized personnel. However, they will be exposed to some of the costs and burdens through business relationships with companies that fall

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Action Plan for Business and Human Rights. Federal Ministry of Labour and Social Affairs, Business and Human Rights, Supply Chain Act, Frequently Asked Questions, *op. cit.*

<sup>117</sup> Federal Ministry of Labour and Social Affairs, Business and Human Rights, Supply Chain Act, Frequently Asked Questions, *op. cit.*

<sup>118</sup> European Commission, Directorate-General for Justice and Consumers, Torres-Cortés, F., Salinier, C., Deringer, H. *et al.*: *Study on due diligence requirements through the supply chain: final report*, *op. cit.*, p. 319.

<sup>119</sup> European Parliament, Fact Sheets on the European Union, [<https://www.europarl.europa.eu/factsheets/en/sheet/35/company-law>], accessed on 10/11/2022.



within the scope, as the CSDD indirectly applies to SMEs that are part of the value chains of larger companies. Therefore, companies whose business partner is an SME are required to assist them in complying with due diligence requirements if such requirements would jeopardize the viability of the SME.<sup>120</sup> However, the financial sector value chain does not include SMEs that receive loans, credits, financing, insurance, or reinsurance.<sup>121</sup>

Under French law, SMEs do not fall directly within the personal scope of the *Loi de vigilance*. In practice, however, as subcontractors or subsidiaries of the company fall within the scope of the law, they are likely to feel its effects. This effect may occur through contractual clauses in B2B business contracts and other measures.

In France, it is estimated that „80% of French SMEs and midcaps (which do not fall within the scope of French law) are asked by their contractors on CSR issues to sign a charter or code of conduct, to commit to complying with key social and environmental standards (health/safety, waste management, business ethics or human rights), sign clauses in their contracts or undergo an extra-financial audit.“<sup>122</sup>

As a rule, companies that do not fall within the scope of the German LkSG must also comply with their due diligence obligations under the National Action Plan on Business and Human Rights (NAP), which sets out corresponding expectations for all companies based in Germany and has already been in force since 2016.

In addition, if companies outside the scope of the LkSG are direct suppliers to companies covered by the LkSG, they may be required to comply with due diligence obligations as part of their contractual relationship (which may include, for example, provisions setting out human rights-related expectations). However, due to their nature, the obligations of the LkSG cannot simply be shifted to suppliers. This applies, for example, to reporting obligations to the authority and the public. In addition, companies subject to the LkSG remain responsible for keeping track of their supply chains and complying with obligations to conduct a risk analysis and take preventive and remedial action.

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<sup>120</sup> Preamble of the CSDD, p. 47.

<sup>121</sup> Explanatory memorandum of 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/2022/71 final, 2022/0051(COD), 23/02/2022), p. 14.

<sup>122</sup> Pietrancosta, A.: *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, op. cit., p. 26. Commission Staff Working Document, Impact Assessment Report, op. cit., p. 27.

In both France and Germany, there are initiatives proposing to extend the scope of due diligence/vigilance obligations to SMEs. It is argued that SMEs can also have significant negative impacts on human rights and environmental issues if they operate in a risk sector.<sup>123</sup> One of the proposals is to impose a much-simplified version of due diligence obligations on SMEs.<sup>124</sup> The same position is taken by some scholars regarding the scope of application of the CSDD. They propose to extend the scope to SMEs, defining it by size or sector.<sup>125</sup>

## 7. CONCLUSION

The Commission's proposal on CSDD, published on February 23, 2022, is inspired by and built on the French model. The two articles of the French Commercial Code are expanded in the EU proposal to some thirty articles setting out the due diligence obligations to be imposed on a broader range of companies, including non-European companies operating in Europe, concerning actual and potential adverse human rights and environmental impacts, about their own operations, the operations of their subsidiaries, and the value chain of operations carried out by entities with which the companies have established direct or indirect business relationships.<sup>126</sup> Companies must monitor adverse human rights and environmental impacts not only by themselves and their subsidiaries but also by entities that are part of their value chain and with which they have an established business relationship, regardless of where they are incorporated or located.

A comparison of the French and EU texts shows that, despite the general inspiration and direction, there are significant differences between the two models in terms of scope, the content of obligations, and enforcement. The European proposal appears more comprehensive, extensive, detailed, and threatening to the corporate status quo. It contains several technical references that should be clarified or corrected during the negotiation process for the final text. It also contains a number of policy choices that differ from those in French law. These include 1) application to a broader range of companies, including non-

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<sup>123</sup> Initiative Lieferkettengesetz, What the new Supply Chain Act delivers – and what it doesn't, *op. cit.*, p. 5

<sup>124</sup> Clerc, C.: *The French 'Duty of Vigilance' Law: Lessons for an EU Directive on Due Diligence in Multinational Supply Chains*, *op. cit.*, p. 3.

<sup>125</sup> Methven O'Brien, C.; Martin-Ortega, O.: *Sustainable corporate governance: Submission to Consultation on European Commission's proposal for a Directive on corporate sustainability due diligence COM(2022)71 final*, *op. cit.*, p. 7.

<sup>126</sup> Pietrancosta, A.: *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, *op. cit.*, p. 22.

EU companies operating in Europe, 2) provisions on climate change, and 3) the introduction of a general duty of care for directors on various social and environmental issues, which is likely to face strong national opposition.<sup>127</sup> Compared to the French system, the European proposal is much more specific and detailed. It clearly attempts to respond to the criticism that has been levelled at it and at the European Parliament's March 2021 resolution.<sup>128</sup>

With the LkSG, which will come into force on January 1, 2023, the German legislator has also regulated the issue of due diligence in the value chain. Compared to French law, the German LkSG is much more detailed. The German solution also differs from the French solution and the CSDD in terms of personal scope. While the LkSG and its obligations only apply to companies with more than 3,000 employees in Germany (the LkSG provides for an extension of the personal scope to companies with more than 1,000 employees in Germany from 2024), the CSDD has a broader personal scope.

The extended personal scope, which prescribes due diligence in the upstream and downstream value chain worldwide and provides for liability for having established business relationships with business partners who do not comply with human rights and environmental law conventions, is assessed as extraterritorial, a kind of „Brussels effect“ for companies outside the EU.

It is specifically noted that non-EU parent companies operating in the EU through their subsidiaries would be indirectly affected by the application of the CSDD.<sup>129</sup> For example, if an EU subsidiary of a non-EU parent is subject to the CSDD because it exceeds the required quantitative (and possibly qualitative)<sup>130</sup> thresholds, the non-EU parent would have to adjust accordingly. This is because the parent company's business is part of the subsidiary's value chain that falls under the regulatory umbrella. Therefore, the non-EU parent would have to comply with the international conventions listed in Annexes 1 and 2 of the CSDD. Otherwise, its non-compliance could be considered non-compliance at the subsidiary level, as the parent company is part of the subsidiary's supply chain. However, under the domestic law of the non-EU parent, a particular international convention might not be part of the hard law, either because it has been ratified but is subject to a reservation, or because it has not been

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<sup>127</sup> *Loc. cit.*

<sup>128</sup> *Ibid.*, p. 32.

<sup>129</sup> Enriques L.; Gatti M: *Extraterritorial Impact of the Proposed EU Directive on Corporate Sustainability Due Diligence: Why Corporate America Should Pay Attention*, [<https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/extraterritorial-impact-proposed-eu-directive-corporate>], accessed on 10/11/2022.

<sup>130</sup> i.e. high sector

ratified at all. Enriques and Gatti<sup>131</sup> cite as an example the 1949 ILO Convention on the Right to Organise and Collective Bargaining, which has not been ratified in the United States. As a result, the labor practices of the U.S. parent company may not meet international standards and could be considered to have an „adverse impact on human rights“ making the EU subsidiary liable for non-compliance. Sanctions imposed on the subsidiary would also impact the U.S. parent company. Companies under the umbrella of the CSDD should monitor not only themselves and their subsidiaries, but also companies that are part of their value chain and with which they have an established business relationship, for adverse human rights and environmental impacts, regardless of where they are incorporated or located. In addition, the CSDD requires that the target company first prevent these “adverse impacts”. If that is not possible, it should bring them to an end. And if that is not possible, Member States must ensure that companies minimize the extent of these impacts (Article 8(2) of the CSDD).

Another problem is the definition of the legal concept of sustainability. Sustainability as a legal concept is defined in many provisions of human rights and environmental law conventions, listed in Annexes 1 and 2 of the CSDD. Because of the general wording regularly used in international conventions, directors may have difficulty identifying the precise obligations of companies. The provisions of these conventions were originally directed at signatory countries, not companies. However, companies and their directors could face very harsh sanctions if they breach these very generally defined obligations. These new obligations and liabilities could cause directors to become fearful and defensive. The insurance market will certainly grow as new liability risks need to be covered. Another concern is the cost of these new due diligence obligations. Although it could be argued that target companies can afford these costs because of the amount of their net turnover, sustainability due diligence extends far beyond the company itself. It also extends to established customers and suppliers upstream and downstream in the value chain. A new set of obligations will therefore increase compliance costs. As a result, target companies may be at a competitive disadvantage compared to companies outside the scope of the CSDD. This will affect the speed of their adaptation, which is crucial for the survival of the company.

By indirectly imposing EU-accepted standards and values in several areas that are critical to business operations, the CSDD would extend the extraterritorial reach of EU law in areas that are both highly politically sensitive and critical to a country’s decisions about how to ensure the international competitiveness

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<sup>131</sup> Enriques L.; Gatti M: *Extraterritorial Impact of the Proposed EU Directive on Corporate Sustainability Due Diligence: Why Corporate America Should Pay Attention*, *op. cit.*

of its businesses.<sup>132</sup> Thus, non-EU companies that have a substantial part of business in Europe will thus have to decide whether to move out of the EU or comply with EU rules.

As Pargendler<sup>133</sup> noted, the CSDD departs from its predecessor, the NFRD, because the relevant thresholds in the CSDD, which are based on a minimum number of employees and net turnover are measured at the entity level rather than at the group level. Thus, the CSDD departs from the approach adopted in the NFRD, which defines the relevant thresholds on a group-based and consolidated basis. Thus, the current text offers the company a relatively easy way to circumvent the CSDD,<sup>134</sup> as a sort of defensive tactic. Targeted companies could segment their businesses by founding new subsidiaries and ensuring that they never exceed the thresholds. In particular, they can ensure that their high-risk business operations, which are subject to lower threshold, are restructured into scalable corporate forms that do not exceed the thresholds.

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<sup>132</sup> *Loc. cit.*

<sup>133</sup> Pargendler M.; *The EU Proposal on Corporate Sustainability Due Diligence and the Mystique of Complete Corporate Separateness*, [<https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/eu-proposal-corporate-sustainability-due-diligence-and-mystique>], accessed on 10/11/2022.

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