Aligning the EU Due Diligence Directive with the International Standards: Key Issues in the Negotiations

SHIFT’S ANALYSIS

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Right now, the EU is in the process of negotiating a legal instrument that will establish new corporate human rights and environmental due diligence duties across the single market – the draft Corporate Sustainability Due Diligence Directive (CS3D). At the heart of the negotiations is how to ensure the CS3D is meaningful in driving better human rights and environmental outcomes while also being manageable for companies.

The international standards on sustainability due diligence – the UN Guiding Principles on Business and Human Rights (UNGPs) and the OECD Guidelines for Multinational Enterprises (OECD Guidelines) – help answer precisely that question. So it is not surprising that the positions of the institutional negotiators have increasingly built on the core concepts in those standards as the process has moved forward. Not only have they been shown to work in practice – for the CS3D to diverge from them would risk creating a fragmented approach that is out of step with the global consensus these standards reflect and that would lead to confusion for companies that have been working to implement them for over a decade now.

This crucial phase of negotiations is a vital opportunity to align the CS3D with the core concepts in the international standards. In this snapshot, Shift takes stock of where progress has been made – and where work still remains – to ensure greater alignment between the positions of the three EU political institutions – the Commission, Council and Parliament – and the international due diligence standards.
On the positive side, there has been progress in the Council and Parliament positions on:

1. Integrating a true risk-based approach to identifying and taking action on impacts
   - Looking across all three potential modes of involvement in impacts under the international standards (i.e., cause, contribution and direct linkage);
   - Using severity and likelihood to prioritize impacts for attention, where necessary, informed by meaningful consultation with affected stakeholders.

2. Setting different expectations for action depending on how a company is involved with an impact
   - Integrating the ‘involvement framework’ from the international standards (i.e., differentiating the action expected of a company based on the mode of its involvement);
   - Paying greater attention to remedy for actual impacts distinct from mitigation.

3. Separating the scope of the due diligence duty from the scope of civil liability
   - Tying civil liability to well-established concepts of a causal connection (including contributing to harm) in national law so that not every breach of the duty may give rise to liability;
   - Distinguishing the roles of administrative supervision and civil liability as complementary enforcement mechanisms.

However, key areas for further alignment include:

1. Ensuring that the due diligence duty applies to the full value chain
   - The Commission proposed that all business relationships across a company’s value chain should be in scope for due diligence, in line with the international standards; but the Council has limited this to upstream and only some downstream relationships which would leave the most severe risks in critical sectors largely out of scope.
   - Parliament has provided a more nuanced definition that would cover a wider range of relationships, in line with the international standards and with new EU sustainability reporting requirements.

2. Moving from a policing to partnership approach in defining how companies should prevent and address impacts
   - The Parliament’s position recognizes the need for companies to consider risks connected to their own business model and strategy and any potential contribution to impacts, and to ensure that contracts with business relationships are accompanied by measures to support due diligence.
   - This is essential to ensure that the Directive creates the right incentives for companies to meaningfully tackle sustainability risks rather than pointing the finger elsewhere or simply divesting from challenging relationships or contexts, leading to worse outcomes in practice.

3. Aligning the scope of covered companies, including application to financial institutions, with existing EU reporting requirements
   - At a minimum, the CS3D should align with the scope of new European sustainability reporting requirements.
   - Better integration of core due diligence concepts, combined with recognition of how financial institutions implement due diligence in practice, can help address the concerns that are currently leading to problematic carve-outs for the financial sector.
In 2022, the EU began negotiating the CS3D. European law-making involves the three political EU institutions: the Commission, Council and Parliament.

In July this year, the three institutions began negotiations in ‘trilogue’ on the text, with the final result expected before the European Parliamentary elections in mid-2024. Once a Directive is adopted, European Member States would then have a certain period of time (likely two years) to transpose it into national law, after which enforcement would commence. Enforcement periods may differ (i.e., be staggered) for different groups of companies in the final Directive.

Shift welcomes the EU stepping into a leadership position on mandatory human rights and environmental due diligence. The CS3D represents an unparalleled opportunity to advance outcomes for people and planet by scaling the uptake of quality due diligence and enhancing corporate accountability for due diligence failures, as noted in our response to the Commission’s original proposal. However, to realize this potential, the Directive must be firmly grounded in the international standards. At Shift, we are committed to helping ensure that this happens through our close involvement in the regulatory debate.

In whatever form it is adopted, the CS3D will provide – by definition – at least a minimum level of harmonization of national due diligence laws across the single market for companies covered by the Directive. Some businesses are calling for the Directive to require full harmonization with its terms by Member States. While this desire is understandable, in Shift’s view, this makes sense only to the extent that the CS3D itself aligns with the international due diligence standards. Otherwise, it will lead to fragmentation with current reporting requirements and with other standards of business conduct grounded in the UNGPs and OECD Guidelines. It will also constrain (rather than enable) Member States’ policy space to support, incentivize and require companies to meet their due diligence responsibilities under the international standards.

The core concepts in the UNGPs form a coherent package that defines a principled yet workable ‘risk-based approach’. This combines looking at impacts arising across a company’s operations and full value chain with prioritization (where necessary) on the basis of the most severe impacts. It is grounded in an ‘involvement framework’ that differentiates how companies should respond to different impacts depending on how they are involved with them, and that makes these expectations both reasonable and adaptable to all risks, sectors and sizes of company. Following this approach, companies can do due diligence on downstream risks; companies with 250 employees or fewer can do due diligence; and companies can manage civil liability concerns arising from negative impacts. In Shift’s view, this is not the moment to pick and choose among the core definitions and concepts in the international standards but rather to take advantage of the common ground they provide to agree a final CS3D text.
This is even more important in light of the recent adoption by the EU of the Corporate Sustainability Reporting Directive (CSRD) and the European Sustainability Reporting Standards (ESRS) that underpin it. These require sustainability disclosures that are aligned with the international due diligence standards in nearly all key respects, including in their focus on salient human rights issues across the full value chain, meaningful engagement with affected stakeholders and consideration of the risks connected to a company’s business model and strategy. To diverge from these disclosure expectations in the conduct requirements of the CS3D would create confusion for companies and other stakeholders, since many (if not all) of the same companies will now be required to align with the international standards in their public reporting on how they are managing material sustainability risks and impacts. Calls for alignment with the international standards are at the core of the numerous business and investor statements of support for a robust CS3D.

Of course, even where there may be general agreement on alignment with the international standards, there are differing views on how to translate such alignment into language that provides sufficient legal certainty on what is expected of covered companies. This is especially so when working on the text of a Directive, which cannot be expected to include all the detail that will need to sit in subsequent authoritative implementation guidance. As demonstrated by more than a decade of practice, these core concepts and points of principle will make the difference between a Directive that merely incentivizes a minimum level of compliance and one that puts sustainability at the heart of how business is done.

As trilogue discussions intensify, this briefing note explores some of the critical topics on which the final CS3D needs to align with the international due diligence standards.
This note covers 12 key issues at stake in the trilogue negotiations on the CS3D regarding the extent of the alignment of the final text with the international due diligence standards. The issues are grouped in three clusters:

- **Scope of the due diligence duty:**
  - Companies subject to the duty
  - Coverage across the value chain

- **Elements of the due diligence duty:**
  - Involvement framework
  - Risk assessment and prioritization
  - Risks connected to business model and strategy
  - Using leverage, including through disengagement
  - Remedy and grievance mechanisms
  - Engagement with affected stakeholders
  - Due diligence by financial institutions

- **Enforcement and accompanying policy measures:**
  - Civil liability
  - Administrative supervision
  - Accompanying policy measures

Each section sets out what the international standards (especially the UNGPs) expect on each issue, identifies positive elements in the Commission, Council and Parliament positions, and identifies where further alignment is needed.
1. Scope of covered companies

What do the international standards say?

The responsibility to respect applies to companies of all sectors and all sizes. The international due diligence standards are successfully applied by companies of all sizes, including those with a small workforce, because the core concepts create reasonable expectations that are tailored to the nature of a particular company’s sustainability risks and impacts.\(^4\)

What would closer alignment look like?

The CS3D should at least align with the scope of application of the CSRD to create harmonized expectations. Under the CSRD, companies with 250 staff or above as well as listed SMEs will be required to explain their approach to material sustainability risks and impacts. This implies that they are expected to also manage those impacts. Decoupling the scope of the due diligence duty under the CS3D from the EU’s own sustainability reporting requirements would lead to some of the same pitfalls that have been seen in the implementation of existing reporting-only requirements in the UK and Switzerland among others. These often lack enforcement mechanisms and have not been shown, on their own, to reliably lead to sufficient change in underlying corporate conduct, as identified in the study conducted for the Commission during its initial consultation on a potential Directive.\(^5\) The inclusion of financial institutions is discussed further below.
2. Scope of due diligence across the value chain

What do the international standards say?

All companies have a responsibility to prevent and address negative impacts connected with their activities, products or services, whether they occur in their own operations (eg, in offices, sites, factories), their upstream value chain (eg, through the actions of suppliers through which they source raw materials or products) or their downstream value chain (eg, third party sales channels, distribution and logistics networks, waste and end-of-product lifecycles). Given the scale and complexity of many global value chains, the international standards outline how companies can manage the challenges of dealing with many layers of upstream and downstream business relationships by carrying out a broad risk mapping to identify general areas of significant risk to people or the environment and then prioritizing impacts within those areas on the basis of severity and likelihood (see further below).

Calls for a ‘risk-based approach in line with the international standards’ that would only apply to parts of the value chain are therefore inherently contradictory. They would direct companies in sectors where the most severe impacts occur as a result of downstream application of their products or services (such as tech, pharmaceutical and construction) to focus their attention and resources on areas of the upstream value chain where risks may be less severe. This would create another mismatch with the EU’s new reporting requirements with companies potentially being required to manage impacts that they do not have to report on, and report on issues they do not have to manage.

A company needs to pay attention to risks arising from the application of its products or services but this is not the same as expecting the company to control those risks. As discussed below, the ‘involvement framework’ in the international standards provides some reasonable limits on what a company is expected to do about risks arising from other entities’ conduct. For example, an EU consumer goods company sells a refrigerator to a retailer who then sells it to an individual consumer – which they then dispose of by dumping it in a river, causing environmental and human rights harms. The product is not inherently risky but there was a foreseeable risk of improper disposal of household goods. So the company made sure that any toxic chemicals were contained in robust casings, provided information about safe disposal and clear warnings to consumers about the risks of improper disposal, and required retailers to pass on those warnings. In this case, the company adopted reasonable steps in its R&D and immediate sales and marketing practices to mitigate the foreseeable risks. Under the international standards, it has done what it reasonably can and would not be seen as contributing to the harm. Nor would it remain linked to the harm because an individual consumer is not typically a ‘business relationship’ under the international standards. This would remain the case even if an individual consumer on-sells the product and harm is then caused.
What would closer alignment look like?

The Commission’s original proposal correctly applied the due diligence duty to the full scope of a company’s value chain; however, it also introduced the problematic limiting concept of ‘established business relationships’ as a way of narrowing the universe of relationships that a company was required to consider.

In a positive development, the Council and Parliament have moved away from ‘established business relationships’. But the Council has adopted an approach that still restricts the scope of the duty by calling out specific entities in a company’s value chain that are covered. It introduces the term ‘chain of activities’ to distinguish this from a full value chain approach and to limit the reach of the duty. The Council proposes that the duty cover all upstream relationships (importantly including in relation to design) but be limited in the downstream context to distribution, logistics and disposal activities where those are carried out by entities ‘for or on behalf of the company’. This is a problematic and gameable approach that has the obvious potential to create perverse incentives for companies to recategorize relationships and/or to ignore more severe risks in the parts of their value chain that are not covered.

Parliament has built on the Council’s approach but has included activities as well as entities within the definition of the value chain, as well as important additional aspects of the value chain, particularly the sale of products and services. This is closer to the definitions adopted under the CSRD and ESRS, which would help bring greater coherence to what is already expected of companies in the single market, reflect existing practice, and respond to stakeholder concerns about the importance of a full value chain approach. It also rightly brings focus to the full range of a company’s own activities related to commercialisation and distribution and how they may heighten or reduce sustainability risks downstream, just as a company’s purchasing practices can heighten or reduce risks upstream.

The Council position also introduced an exclusion for products subject to export control under Regulation 2021/281 by national authorities. Dual-use items and other products subject to export control, particularly in the ICT and defense sectors, require export licenses precisely because they can be misused in a way that severely impacts human rights – and leading companies in those sectors carry out due diligence accordingly. Regulation 2021/821 itself acknowledges the need for companies to conduct due diligence at least in relation to cyber surveillance items. So rather than providing a blanket exemption, the final CS3D could help ensure that such due diligence efforts are harmonized and carried out to a certain degree of quality, thereby supporting competent national authorities in their decision-making and helping to ensure all reasonable mitigation approaches have been taken in advance of decisions authorizing export.
1. Central Role of the ‘Involvement Framework’:

What do the international standards say?

The UNGPs and OECD Guidelines set out a typology of ways in which companies may be involved with impacts. They may cause or contribute to impacts or their operations, products or services may be linked to impacts through a business relationship. What is expected of the company varies depending on the nature of its involvement. This is captured in the graphic on the following page.
This is central to the effectiveness of the due diligence approach in the international standards for several reasons:

- It clearly differentiates the type of response expected from companies in a way that ensures that those expectations are reasonable and proportionate to the nature of the company’s involvement with an impact;
- Without differentiating what is expected of companies based on the nature of their involvement in impacts, there is little incentive for companies to closely examine their own practices and business models and the unintentional or perverse consequences these may be creating in their business relationships in order to avoid causing or contributing to harm;
- Causation, and contribution as a form of causation, reflect well-established concepts in civil liability under existing national laws, and doing due diligence can help protect companies against claims made on that basis.
What would closer alignment look like?

The Commission proposal does refer to the relevance of a company’s connection to an impact (for example, in Art 8(3)(a)). Yet the Council and Parliament’s positions more clearly integrate the involvement framework from the international standards. The Council explains that its approach in the draft recitals aligns with the international standards but uses the language of causation to define the duty in the legal text (i.e., causing, jointly causing, or caused only by a business partner without contribution by the company). The Parliament aligns the language in its position with that in the international standards.

In Shift’s view, the Council language could work if it includes two important nuances from the Parliament’s text. First, it is important to clarify what is expected of companies under each mode of involvement, ideally in the substantive text in Articles 7 and 8 as the Parliament proposal does. Here, it is essential to distinguish between two types of expectations: first, what is expected in situations of causation or contribution, where the company’s own decisions and activities are involved and its own conduct must be addressed; and second, in situations involving another party where using and building leverage will be relevant (i.e., in contribution and linkage situations). The Parliament text is most aligned with the international standards in spelling out these two broad categories of responses.

Second, it is important to clarify that ‘contribution’ in the final CS3D text (or ‘jointly causing’ in the Council’s terminology) clearly includes situations of ‘contribution in parallel’ under the international standards – meaning situations where a company does not facilitate or incentivize another party to cause harm but harm results from the parallel actions of a company and one or more other entities. For example, several unrelated companies release harmful effluent into a river; each release is under the legal limit, but together they lead to the water becoming polluted, negatively affecting people living downstream.

2. Risk Assessment and Prioritization:

What do the international standards say?

The UNGPs and OECD Guidelines recognize that where companies need to prioritize impacts they should do so on the basis of their likelihood and severity from the perspective of those who are or may be affected. Severity involves considering the scale of an impact (how grave it is), its scope (how widespread it is) and its irremediability (meaning how hard it would be to put right). An impact can be severe even if it would only be so in one of these dimensions. The UNGPs are also clear that in the case of human rights impacts, severity should always be the dominant factor, particularly where delayed action would make an impact irremediable.
What would closer alignment look like?

The Commission proposal recognizes the need for prioritization of impacts as well as the relevance of severity and likelihood, and it defines severity largely in line with the international standards. However, it does not clearly integrate prioritization into the core of the due diligence duty. This creates a real risk that while businesses may prioritize impacts as part of their due diligence, prioritization will be based on a traditional understanding of risk to the business rather than risk to people and planet.

The Council and Parliament positions introduce risk-based prioritization into the core of the duty and more closely align the definition of severity with that in the international standards. However, the final text must recognize that severity is the dominant factor in the case of human rights impacts - meaning that impacts cannot be ignored simply because they are low likelihood, as stated in Guiding Principle 24, the OECD Due Diligence Guidance and recognized in the ESRS as well.

The Parliament stresses that risk identification should include risks that a company may cause, contribute or be linked to in line with the involvement framework. Without making this explicit in the final text, companies may gravitate towards the impacts they feel most able to manage or that are most proximate to their operations, which does not reflect a focus on severity. The Parliament position also makes clear that risk assessment and prioritization is an ongoing expectation that does not stop just because certain risks are appropriately mitigated. Both of these are important points of alignment with the international standards that should be included in a final text.

On the other hand, Parliament’s proposed recital offering companies protection from civil liability where they have prioritized risks is not aligned with the international standards. The UNGPs are clear that companies should not presume that doing due diligence, including prioritization, is a complete or automatic defense to liability, and the credibility of a company’s prioritization process would naturally be reviewed as part of any enforcement action.
3. Considering risks connected to the business model and strategy

What do the international standards say?

Companies trying to manage negative impacts within specific business activities will fail to address those issues if they are embedded in the business model or strategy. As Shift’s work has shown, business models can create or heighten risks to people through:

- The value proposition (what the company offers and to whom) e.g., lowest cost goods or services in ways that put pressure on labor rights;
- The value chain (how the company delivers value) e.g., speed in developing products or services, or delivering projects, with risks to health and safety;
- The cost structure and the revenue model (how the business model is profitable) e.g., using gig workers or other precarious labor.

This is why the UNGPs emphasize the role of the company’s governing body in approving due diligence commitments and the importance of appropriate oversight and decision-making in enabling effective action on identified impacts.

What would closer alignment look like?

In Article 15, the Commission, Council and Parliament all recognize the importance of “adapting the company’s business model and strategy” in service of an effective climate transition plan. While climate change-related impacts are treated distinctly from the core due diligence duty, the same logic should apply to including reference to business models in Articles 7 and 8 in order for the company’s actions to be effective.

The Parliament position integrates the need to adapt the company’s business model and strategy in Articles 7 and 8, with reference to purchasing practices as an example of how a company’s own activities connected to its business model can heighten or reduce risks. In Art 5, Parliament also adds helpful nuance about the importance of tailoring the company’s policy to its most severe impacts, including risks connected to the business model. These additions would help bring the CS3D into alignment with the expectations in the CSRD and the new ESRS, which require companies to disclose how they understand and address the relationship between material impacts on people and their business models.
On a related point, there is a clear opportunity to reflect the need for a just transition by making a stronger link to the human rights implications of climate change in companies’ Art 15 transition plans. The Parliament position provides a hook by recognizing the need to link these plans to the new requirements under the CSRD and the need for companies to explain how their business model and strategy takes account of the interests of affected stakeholders in relation to climate change impacts (in Art 15(1)(f)).

4. Using leverage, including through disengagement

What do the international standards say?

The UNGPs and OECD Guidelines expect companies to take a creative approach to the use of leverage in their business relationships – one that is proportionate to any impacts with which their business partner is involved and is informed by the outcomes they are trying to achieve. Leverage should be grounded in formal agreements such as contracts. Those agreements should reflect both parties’ due diligence obligations and should be accompanied by measures to support and incentivize the partner to take effective action to prevent and address impacts.

The international standards recognize that remaining in a business relationship or particular context may often enable a company to have more leverage than if it were to simply exit – and that exiting may give rise to additional adverse impacts. They acknowledge that it is challenging to prescribe the conditions under which a company should stay in a relationship or should terminate or disengage. Instead, they set out a number of factors that companies should consider when they are unable to effectively use or build leverage to address impacts – specifically, the company’s leverage over the entity concerned, how crucial the relationship is to the company, the severity of the abuse, and whether terminating the relationship itself would have further adverse consequences.

What would closer alignment look like?

The Commission’s original proposal relied heavily on a top-down ‘policing’ model to address risks arising through business relationships, involving practices that effectively outsource responsibility for the management of sustainability risks to business partners through contracts and then police compliance through audits, often without attention to the company’s own actions and decisions such as purchasing practices. Experience over the last decade has consistently shown that such approaches are highly unlikely to result in better human rights outcomes in practice.
The Council did not engage in detail with the main provisions in Articles 7 and 8 that create the framework for expected responses (or ‘appropriate measures’) by companies. The Parliament did, by adding helpful nuance that shifts the focus of expected actions from top-down policing towards mutual due diligence responsibilities, reflected in contracts and demonstrated through a partnership approach. The Parliament position includes critical references to looking at a company’s own conduct (rather than just assuming the problem always lies with business partners), and to using diverse forms of leverage that are appropriate to a partner’s actual situation and capacity. In a crucial sentence, the Parliament position states that “contractual provisions shall be accompanied by measures to support carrying out due diligence” – this concept should be included in the final Directive.

A credible threat of suspension or termination of a business relationship can be an important form of leverage. However this is different from actually suspending or terminating problematic business relationships, which requires careful attention to any new human rights or environmental risks that could be generated. This means that companies need to put in place a robust internal process for deciding when to terminate a relationship, or to take intermediate steps like suspension, that allows for the specificities of the situation.

Unfortunately, the approach to disengagement remains overly prescriptive across all three positions. While the Council was right to recognize the relevance of whether there may be additional adverse impacts from termination and whether the business relationship is a crucial one for the company - both of which are factors identified in the international standards - it places too much weight on them in proposing that they automatically justify companies remaining in a relationship if either factor is present. The Parliament also proposed an overly prescriptive approach that presumes it is always possible to mathematically ‘balance’ whether remaining in a relationship or terminating it will result in more severe impacts. By relying on prescriptive solutions, both positions automatically lead to carving out ‘blanket’ exemptions for companies in certain situations or in certain sectors, undermining the role of termination as a potential source of leverage.

In the final text, it will be important to preserve these factors (particularly the severity of any additional adverse impacts) but to more closely align with the international standards by recognizing that suspending or terminating a relationship should be seen as part of a wider leverage strategy to address severe impacts, rather than a predetermined balancing exercise with mandatory conclusions and blanket exemptions. In fact, the best way to ensure companies make responsible and well-informed decisions about termination is to insist on the importance of meaningful engagement with affected stakeholders (or credible proxies for their views where such engagement is not safe or feasible) and experts as part of that process. In its additional Art 8d, the Parliament provides that the termination of business relationships requires engagement with affected stakeholders; this should be reflected in the final Directive.
5. Remedy and Grievance Mechanisms

What do the international standards say?

Remedy means returning an affected stakeholder to the position they were in before a harm occurred, or as close to that position as possible. Restoring environmental harm follows a similar logic. Remedy (or remediation) has both a process and outcome component, and the process of providing or enabling remedy can affect whether stakeholders experience an outcome as ‘remedy’ or not. Hence the international standards expect companies to develop effective operational-level grievance mechanisms as a complement to state-based remedy mechanisms (such as courts and non-judicial processes) that meet certain standards set out in Guiding Principle 31.

Remedy can take many forms, including apologies, restitution, rehabilitation, financial or non-financial compensation, punitive sanctions and the prevention of future harm (for example, through guarantees of non-repetition). Companies are expected to provide or enable access to remedy where they cause or contribute to harm, according to the extent of their contribution. In linkage situations, a company is not responsible for remedying harm it did not contribute to. However, it is expected to use leverage to seek to prevent future harms; in practice, urging a business partner to provide remedy can be one of the most powerful forms of leverage as the partner is more likely to take action to prevent similar harms from recurring. This is reflected in the graphic summarizing the expectations of action in the international standards above.
What would closer alignment look like?

In the Commission’s original proposal, there was limited attention to the concept of remedy. Instead, there was reference to ‘neutralizing’ adverse impacts through the payment of financial compensation to affected persons. The Council took critical steps to more closely align the text with the international standards by integrating a definition of remedy and providing for a general expectation of remediation in **Art 8(3)(g)**. Parliament built on this in its proposal of a new **Article 8c**, including drawing attention to the need for companies to seek to enable remedy in linkage situations in **8c(4)**.

With regard to the processes that companies should put in place to help enable remedy, the Commission recognized their importance and that diverse individuals and groups should be able to submit complaints. This obviously includes affected stakeholders but is not limited to them. The Council position rightly includes a greater focus on the procedural aspects and design of grievance mechanisms that can affect their legitimacy and the safety of complainants. If mechanisms are not seen as legitimate and safe by potential users they are unlikely to be of much value to stakeholders or indeed to companies themselves. Parliament helpfully added a reference to the full effectiveness criteria for grievance mechanisms in GP 31, which are the basis of substantial guidance by the UN Office of the High Commissioner for Human Rights (OHCHR) as well as practical investment by companies and stakeholders.\(^{15}\)

However, the Parliament position has also complicated the role of grievance mechanisms by trying to distinguish between complaints and ‘notifications’ at the point of submission and allocating different procedural rights to those raising concerns. Operational-level grievance mechanisms perform two roles under the international standards: they can be a source of remedy (where a company has caused or contributed to harm) and they can be a source of information to improve a company’s due diligence processes (for example, by providing early warning of issues that could escalate into severe impacts if left unchecked). To perform these two functions, it helps to make them accessible to a variety of individuals and groups; however, this does not mean that every issue lodged with the mechanism will require remedy. Creating artificial distinctions before concerns have even gone through an initial assessment is unlikely to make the system more manageable in practice or lead to greater trust from users. A clearer approach can be found in the Parliament’s proposal to require company grievance mechanisms to meet the UNGPs effectiveness criteria, which consider both the rights and needs of complainants, as well as what is feasible for companies.
6. Engagement with affected stakeholders

What do the international standards say?

In order to manage their sustainability impacts effectively, companies need to understand the perspectives and concerns of affected stakeholders – meaning those individuals and groups that are or may be affected by the company’s operations, products or services or their legitimate representatives (such as trade unions, where workers are unionized). Such consultation should be meaningful and pay particular attention to those who may be most vulnerable to impacts. It should account for the specificities of the context (such as being conflict-sensitive) and the needs of the relevant stakeholders (such as being gender-responsive).

Companies can use a variety of means to gain insight, including by consulting with credible proxies for affected stakeholders’ views where it is not possible to consult with affected stakeholders or their legitimate representatives directly (such as local NGOs). Human rights and environmental defenders will often be affected stakeholders themselves; where they are not directly affected, they are likely to be a credible proxy.

The purpose of this consultation is to inform the company’s due diligence efforts – in particular its identification, assessment and prioritization of risks, as well as tracking the effectiveness of its efforts to address them.

What would closer alignment look like?

The Commission proposal recognized that stakeholders, including affected stakeholders, should have a role in due diligence, focused on the development of a policy, the identification of impacts and the development of (optional) prevention action plans. The Council largely followed this approach.

The Parliament took a more comprehensive view, in line with the international standards. It focused the definition of stakeholders in Art 3 on affected stakeholders and their legitimate representatives. It also adopted the concept of meaningful engagement, including ensuring engagement is safe for stakeholders, and recognizing the role of credible proxies where needed. This clarifies the difference between sustainability due diligence and the type of stakeholder consultation that focuses on stakeholders who are the most influential or vocal but not necessarily the most severely impacted. The Parliament position adds a focus on vulnerability – this is not a separate category of stakeholders but rather the result of various factors that can heighten vulnerability for certain individuals or groups and could be integrated into the main definition.
Crucially, **Art 8d** recognizes that monitoring under **Art 10** is an ongoing process and that affected stakeholder feedback is essential to it; it will be important to retain this in the final text. Some of the remaining detail in the Parliament’s proposed **Art 8d** could be more appropriately included in guidance rather than in the text of the Directive.

### 7. Due diligence by Financial Institutions

**What do the international standards say?**

Financial institutions are also expected to carry out due diligence for sustainability risks and impacts under the international standards. The core concepts in those standards that make due diligence feasible for a wide variety of companies also make it so for financial institutions. Where financial institutions differ is in the implementation of due diligence. For example, given the often vast portfolios of client or investee companies, it is natural for financial institutions to have to prioritize among general sectors or sub-sectors and to assess risks associated with individual companies within those targeted areas. Their due diligence will also normally be focused on the commitment, capacity and track record of their immediate clients or investee companies to managing salient risks within their own value chains, rather than on engaging with entities in their clients’ value chains directly.

**What would closer alignment look like?**

The Commission and Parliament both propose covering a range of financial institutions, including banks, insurance companies and investors. The Council excludes investors and leaves it up to EU Member States to decide whether or not to apply the CS3D to banks and insurance companies, creating an ‘opt-in’ approach. It also limits the scope of the CS3D to specific financial services.
All three positions create certain exceptions for financial institutions in how they should carry out due diligence. These exceptions do not align with the international standards, nor with the practice of financial institutions that are already conducting sustainability due diligence on the basis of those standards. First, they propose that potential and actual impacts associated with small- and mid-size business partners do not have to be addressed regardless of the inherent riskiness of their sector or operations. Second, the Commission and Council allow financial institutions to ignore negative impacts in the value chains of their business partners, even when their financial services are specifically tailored to facilitate these activities (such as trade finance for certain predictably high-risk commodities). Third, financial institutions would also be allowed to ignore impacts that arise after the start of a business relationship (although the Parliament adds that these impacts need to be considered when the financial institution is alerted through its grievance mechanism). These exceptions all appear to be motivated by a concern that financial institutions can be involved with negative impacts at a scale that is unmanageable, and which must therefore be narrowed down.

Importantly, the international standards already allow financial institutions to tailor the nature of their due diligence to their operations. The integration of the involvement framework and risk-based prioritization (as described above) into the due diligence duty in the final CS3D would significantly reduce the need for special exceptions. In addition, the final text could note in the recitals some of the key ways in which due diligence is made manageable for financial institutions. For example:

- It could recognize that financial institutions will conduct their initial prioritization process based on exposure to certain sectors, before identifying whether individual business partners are indeed involved with those impacts and how they are addressing them. This would align much more closely with current practice among leading institutions than the proposal that they should limit due diligence to the pre-contractual stage but apply it to all their direct business partners.

- The value chain definition for financial institutions could clarify that they are expected to focus on assessing the commitment, capacity and track record of how their direct business partners manage impacts in their own value chains, and are not expected to engage with indirect business partners as part of normal due diligence.
The recitals could note that when financial services are tailored to specific activities, for example in the case of project finance, asset-based finance and trade finance, the financial institution’s value chain (for the purposes of the transaction) does not include impacts that the client is involved with outside these specific activities.

With regard to the specific provisions on financial institutions in Arts 7 and 8 regarding the temporary suspension or termination of business relationships, the concerns currently motivating these blanket exemptions could be addressed by adopting a factor-based approach to disengagement that more closely aligns with the international standards, as set out above. Also problematic is the ‘presumption of direct linkage’ for financial institutions introduced in the Parliament position in Arts 7(1b) and 8(2b). This runs counter to authoritative guidance from the OECD and UN OHCHR that recognizes that while this may often be the case, financial institutions should not make that assumption. It would be more appropriate for the recitals to recognize, for example, that merely providing financial services to a client that is involved with negative impacts does not imply, on its own, that the financial institution is contributing to those impacts.

In sum, it is only to be expected that financial institutions will carry out due diligence in ways that are appropriate to their business model and operations and the final text can acknowledge that without creating new regimes or exceptions that lead to perverse results. This requires adopting a two-step approach: first, better integration of the core concepts from the international standards, and second, recognition in the recitals of how they can be implemented in the case of financial institutions, given their typically vast portfolios.
ENFORCEMENT: HOW CAN CIVIL LIABILITY, ADMINISTRATIVE SUPERVISION AND ACCOMPANYING POLICY MEASURES BEST SUPPORT EFFECTIVE DUE DILIGENCE?

1. Civil liability:

What do the international standards say?

The UNGPs do not prescribe how the involvement framework maps to civil liability under national law. However, they are explicit that conducting due diligence should help a company address the risk of legal claims against it by showing that it took every reasonable step to avoid causing or contributing to harm, thereby recognizing the relevance of due diligence as a defense to civil liability. The UNGPs are also clear that companies should not assume that conducting due diligence will on its own completely absolve them from liability for causing or contributing to harm – meaning that due diligence should not function as a ‘safe harbor’ in the sense of a total bar on claims.

The UNGPs reiterate the fundamental duty of states to take appropriate steps to ensure access to effective remedy for business-related harms, including through judicial mechanisms. They recognize that claimants in cases alleging harm involving businesses often face significant legal and practical barriers to accessing justice and that states should take appropriate steps to reduce these, particularly for individuals at heightened risk of vulnerability or marginalization.
What would closer alignment look like?

In the Commission’s proposal, liability applies in case of any failure to meet the duty where damage occurs – meaning that the scope of the duty and liability are the same. The Commission created a rebuttable presumption against liability in Art 22(2) where a company has put in place contracts and accompanying audits with an indirect business relationship. Not only is there a lack of evidence that such measures can be an effective way to address impacts deeper in a company’s value chain, this approach is in tension with the need to evaluate the appropriateness of a company’s due diligence as a whole in any particular case.

The Council and Parliament positions instead focus on the fundamental role of a causal link (whether through sole causation by the company or a form of contribution) between a company’s due diligence failure and a harm. Requiring a causal link between a fault and harm is common to many national systems. This also mirrors the approach in other EU laws, for example on product liability. The appropriateness or quality of a company’s due diligence is then relevant as a potential defense to liability. All three positions recognize, for example, that account should be taken of any remedial steps already taken by a company.

The three political institutions importantly agree that the provisions of the CS3D should be of ‘overriding mandatory application’ where the applicable law would otherwise not be the law of the Member State (broadly meaning that it will apply to any disputes in Member State courts even if the impacts occurred in a non-EU country). While none of the positions reverse the burden of proof, the Parliament position does include other critically important aspects of enabling access to justice in Art 22(2a), many of which have been highlighted in the commentary to UNGP 26, in OHCHR’s Accountability and Remedy Project and by the EU Fundamental Rights Agency as issues requiring Member States’ attention and which should be addressed in the final text and through appropriate accompanying measures.19
2. Administrative supervision:

What do the international standards say?

The UNGPs reflect the expectation that states should provide effective and appropriate non-judicial mechanisms, alongside judicial mechanisms, as part of a comprehensive state-based system for the remedy of business-related human rights abuse. As work by OHCHR and Shift has shown, administrative supervisory mechanisms can play an essential and complementary role to civil liability by providing guidance to business and driving improvements in practice as well as functioning as non-judicial complaints mechanisms.20

When acting as state-based grievance mechanisms, administrative bodies should also meet the criteria in GP 31. The UNGPs recognize the particular role of National Human Rights Institutions in this regard.

What would closer alignment look like?

The Commission’s proposal set out a complementary enforcement approach, encompassing civil liability and administrative supervision. Member States will be required to nominate ‘supervisory authorities’ and should pay particular attention to their legal and functional independence from the companies that they are intended to regulate, including through robust conflict of interest requirements. This is essential to their effectiveness and to ensuring that stakeholders trust the work of these authorities.

Administrative authorities should be given powers to investigate on their own initiative, to receive ‘substantiated concerns’ and to impose ‘effective, proportionate and dissuasive’ sanctions. It will be important that the final text specify what is reasonable in this regard to ensure effective deterrence and prevent against fragmentation in Member State approaches. The Commission proposal also acknowledged the need to give companies reasonable time to address a due diligence failure or harm wherever possible before imposing sanctions.

The Commission recognized that the normal process of administrative review would ensure that either party could challenge supervisory authorities’ decisions in national courts. It also emphasized that Member States should ensure cooperation among such authorities, including through a European Network, which will be vital given the wide-ranging nature of the issues and sectors that national authorities will be required to engage with.
The Parliament position adds a critical focus on transparency, including the requirement that authorities publish a list of covered companies, which has been missing from existing national approaches and is essential for stakeholders to engage effectively with authorities. The Parliament also emphasizes that the complaint function needs to meet the minimum effectiveness criteria in the UNGPs (which, as noted above, apply both to state and non-state based mechanisms).

Administrative authorities will have a particular role overseeing the separate regime of climate transition plans under Article 15. Problematically, the Council position limits this role to checking the existence of the plan only, which invites a paper compliance exercise and will not give stakeholders – whether lenders, investors or NGOs – any confidence in their robustness or reliability. This should be avoided in the final text.

3. Accompanying policy measures:

What do the international standards say?

The UNGPs set out the expectation that states should work to ensure policy coherence across the full range of departments and agencies that deal with business conduct. They should provide guidance to businesses on how to meet their due diligence responsibilities with a focus on expected outcomes. States should take additional steps to protect against harms by businesses that are state-owned or controlled or that receive significant support or services from the state (such as through export credit, development finance or trade promotion support). And they should promote the need for businesses to meet their responsibilities through public procurement.

What would closer alignment look like?

There is a strong focus on support to EU businesses across all three positions, including through guidance and national help-desks and platforms. Clearly authoritative guidance from the Commission on implementation will be important but it must involve engagement with both OHCHR and OECD as the bodies tasked with interpreting the international due diligence standards. The Parliament has recommended a long list of areas where the Commission should provide guidance; it will be important to focus initially on core concepts that are most likely to affect whether due diligence is carried out meaningfully.
All three positions recognize that industry and multi-stakeholder initiatives will naturally play a role in the implementation of companies’ due diligence obligations, but that recognition of this role should depend on the extent to which they are appropriate to support effective due diligence. The Parliament position is most nuanced in recognizing both their value and limitations: initiatives are typically valuable in relation to specific aspects of due diligence rather than as a ‘one-stop-shop’ for due diligence – such as supporting sector-wide risk identification, providing tools for mitigation of specific risks, coordinating the use of companies’ leverage to enable remediation or providing access to a shared grievance mechanism (in Art 14(4)). It is also explicit that participation in a scheme does not automatically affect civil liability; it will of course be a factor to be taken into account by enforcement authorities in evaluating the overall robustness of a company’s due diligence.

There is a critical role for Member States to play in ensuring that their financial and commercial forms of support to business support the logic of the CS3D and help incentivize meaningful due diligence. Both the Commission and Parliament positions support the inclusion of Art 24 which provides that Member States should take account of companies’ due diligence performance in the context of public support. The Parliament also includes a reference to export credits as one tool.

There is limited reference in the three positions to the need to support effective implementation in third countries, which reflects the policy discretion that Member States have in this regard. The accompanying work of the Team Europe Initiative on Sustainability in Global Supply Chains (TEI), specifically the joint intervention logic that the TEI is developing, will be essential to ensure that accompanying policy measures are targeted towards achieving improved outcomes for affected stakeholders in key production and sourcing markets and to support continued engagement and investment by companies in those markets in order to drive up standards of business conduct over time.

The Parliament has added to the list of accompanying policy measures the need for targeted support for affected stakeholders and their legitimate representatives to build their capacity and ensure they have access to information. Member State support will also be essential in focusing on aspects of national law and policy that businesses themselves cannot (and should not) influence, particularly strengthening local state-based mechanisms to support access to remedy in non-EU jurisdictions.
In parallel to the trilogue negotiations that aim to deliver a final text on the CS3D, Parliament and Council are developing their respective positions on the draft regulation on prohibiting products made with forced labor on the Union market (i.e. the Forced Labour Regulation or FLR). Although both proposals entail corporate obligations in relation to adverse impacts on human rights, they take very different approaches.

The CS3D sets out a due diligence duty that would require covered companies to take appropriate measures in order to prevent, mitigate and – depending on the nature of their involvement – remediate adverse human rights impacts, including forced labor. It will likely be enforced through administrative supervision of the overall quality of a company’s due diligence and civil liability in specific cases where there is a causal connection between a company’s acts or omissions and a harm. The FLR provides that no company may make products made with forced labor (in part or in whole) available on the single market (nor export them). This will be enforced by Member States’ custom authorities who will remove products from circulation where there is evidence of forced labor – but the Commission’s proposal does not yet require that companies address the underlying forced labor impacts.

These two legal proposals can be complementary, provided that both their final provisions and respective enforcement logics are more closely aligned around the need to ensure improved outcomes for affected stakeholders (i.e., the people whose rights are impacted by the harms). For example, a company’s efforts to tackle forced labor may not be immediately successful, especially when its products or services are directly linked to a situation of forced labor several tiers away in its value chain. As this briefing note argues, the final CS3D should not contain an overly prescriptive approach to termination of business relationships - that is, making it mandatory when certain conditions are met, while at the same time carving out blanket exemptions from that requirement. Instead, it should integrate a factor-based approach in line with the international due diligence standards. This would help ensure that, after weighing the specified factors, companies may deliberately remain in a business relationship that is involved with forced labor where there are reasonable prospects of addressing the impacts on affected stakeholders and the company has outcome-based, measurable and time-bound plans to do so.
While the FLR does not prohibit this as such, it does prohibit a company from placing any resulting products on the EU market. Unless the FLR proposal is amended in key respects as described below, it risks creating a clear incentive for the importing company to simply disengage and seek alternative business partners. The FLR should support the requirements of the final CS3D, which should ensure that companies carefully consider the potential negative impacts of disengagement, most importantly by integrating insight into the perspectives of affected stakeholders (particularly workers and trade unions) to better understand the situation and what is likely to be effective. This has several implications for the detail of the FLR proposal.

First, in the pre-investigative stage, companies’ own reporting of their due diligence efforts under the CS3D should not be sufficient, on its own, to prevent further action. At the same time, it should be possible for the competent authorities to decide at this initial stage that the company is taking appropriate measures as outlined above and to give it a specific period of time in which the results of those measures should be evaluated before commencing a formal investigation. However, in situations of state-imposed forced labor where individual companies are unable to achieve the kind of change required on their own, the FLR should recognize that value chains involving these situations will require a different response. This could include a (rebuttable) presumption that state-imposed forced labor is occurring but it should also trigger a policy response at the technical and political levels (i.e., the Commission and Member States) to provide guidance about the situation on the ground and what credible sourcing alternatives exist.

Second, once a formal investigation is commenced, the FLR should include an appropriate timeline that allows a company to meaningfully address the impacts, by providing or enabling access to remedy and taking steps to prevent the reoccurrence of forced labor, before the competent authorities are required to order the withdrawal or disposal of products, as this can aggravate the incentives to disengage. The competent authorities should be required to consider the same factors as the CS3D requires companies to consider, again informed by affected stakeholder perspectives.

Third, once a decision to ban products is taken, the threshold that forced labor should be ‘eliminated’ before the competent authority withdraws its decision should be adapted to clearly require remedy for the affected stakeholders and the introduction of measures to prevent its reoccurrence.

Finally, the relationship between the public authorities that are tasked with supervising compliance with the CS3D and the FLR – which in most Member States will likely be different authorities – needs to be clear and well-functioning. Both should work on the basis of a mandate that encourages engagement in supply chain relationships, instead of disengagement, in service of improved outcomes for affected stakeholders.
The ESRS have been proposed as a delegated act by the Commission. The Council and Parliament have a period in which they can formally object but it is expected that the ESRS will be passed by early 2024.

For more detail on how the ESRS align with the UNGPs in particular, see our mini-series available here: https://shiftproject.org/resource/putting-the-esrs-into-practice/.


For examples of this in practice, see the report prepared by Shift for the IOE on SMEs and the responsibility to respect human rights: https://shiftproject.org/wp-content/uploads/2020/01/index.pdf.


The ESRS define the value chain as, “the full range of activities, resources and relationships related to the undertaking’s business model and the external environment in which it operates” (Annex II, Acronyms and Glossary of Terms, p 30). They state that “a value chain encompasses the activities, resources and relationships the undertaking uses and relies on to create its products or services from conception to delivery, consumption and end-of-life... Value chain includes actors upstream and downstream from the undertaking.”


Under Regulation 2021/281, Article 12, an exporter must provide the competent national authority with all relevant information on the end-user, meaning that certain due diligence efforts are required by the company. Additionally, companies already prohibit redistribution of dual-use items through due diligence measures such as implementing contract clauses and requiring confirmation from customers on the end-user of the products.

For examples of how businesses across a range of sectors could be wired to put people at risk, and what can be done to mitigate these risks, see Shift’s Business Model Red Flags.


For more detail on what this looks like see ibid.


As the ESRS makes clear, there are four broad groups of affected stakeholders that companies need to consider in their due diligence – workers in a company’s own operations, workers in its value chain, local communities affected by its operations or those of its business relationships, and consumers and end-users of its products and services. See https://shiftproject.org/wp-content/uploads/2023/08/The-People-Centered-Architecture-of-the-ESRS.pdf.

See, for example, this statement by the UN Working Group on Business and Human Rights and the recent report by a group of French legal experts: Le Club des Juristes, Due Diligence: What’s the Outlook for Europe?, July 2023, available at https://www.leclubdesjuristes.com/wp-content/uploads/2023/07/rapport_VIGILANCE_EN_WEB.pdf. The expert report emphasizes a number of other important points needed for alignment with the international standards.

For examples, see the resources produced through Shift’s Financial Institutions Practitioners Circle available at https://shiftproject.org/what-we-do/finance/fiscircle/.


See https://shiftproject.org/resource/enforcement-mhrdd-design/.
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ALIGNING THE EU DUE DILIGENCE DIRECTIVE WITH THE INTERNATIONAL STANDARDS: KEY ISSUES IN THE NEGOTIATIONS
SHIFT’S ANALYSIS
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ABOUT SHIFT

Shift is the leading center of expertise on the UN Guiding Principles on Business and Human Rights. Shift’s global team of experts works across all continents and sectors to challenge assumptions, push boundaries, and redefine corporate practice, in order to build a world where business gets done with respect for people’s dignity. Shift is a non-profit, mission-driven organization, headquartered in New York City.

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