

Rise of Environmental, Social, and Governance Due Diligence in Europe

[Arnoud R. Willems](#), [Dr. Bregt Natens](#), [Michele Tagliaferri](#), and [Yuliya Gevrenova](#)

On November 29, 2020, the Swiss citizens voted against the popular initiative “For Responsible Enterprises – To Protect People and the Environment” (Initiative), colloquially known as the “Responsible Business Initiative.” The Initiative sought to create unprecedented new obligations for Swiss companies, requiring them to ensure the respect of human rights and international environmental standards throughout their global supply chain and subjecting them to civil liability for the failure of their foreign affiliates and commercially dependent suppliers to do so. Although the Initiative will not translate into a new law, Swiss companies with operations in the European Union (EU) may still find themselves subject to similar due diligence requirements in the near future.

1. The EU Proposal

Earlier this year we [reported](#) that the European Commission was planning to propose new legislation introducing mandatory human rights due diligence for EU companies. In the meantime, the European Parliament’s Committee on Legal Affairs published a [draft report](#) (Report) shedding more light on what companies can expect from the Commission proposal expected to be published in Q2 of 2021. The Report includes the text of a proposed directive (Draft Directive), which recommends a mandatory supply chain due diligence for European companies.

Why should Swiss companies be interested in this development?

The Draft Directive envisages application of the environmental, social, and governance (ESG) due diligence obligations to companies operating on the EU market. Specifically, the Draft Directive is likely to apply to “limited liability undertakings governed by the law of a *non-Member State* and not established in the territory of the Union *when they operate in the internal market selling goods or providing services*(emphasis added).” Thus, Swiss companies that conduct business in the EU directly and not through an EU subsidiary will likely need to follow the new rules.

What does the ESG due diligence obligation encompass?

The due diligence requirement under the Draft Directive is not far from what the Initiative envisaged. On the one hand, the risk that companies need to examine is defined both as any “potential” and “actual” adverse impact on individuals, groups of individuals, and other organizations in relation to human rights, including social and labor rights, the environment, and good governance.

On the other hand, the Draft Directive requires compliance not only with environmental and social international standards but also with international “governance” conventions. When determining the governance risk posed by their activities, companies should consider the potential or actual adverse impact on the good governance of a country, region, or territory, including noncompliance with the Organisation for Economic Co-operation and Development ([OECD Guidelines for Multinational Enterprises](#)), the [OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions](#), and situations of corruption and bribery.

How can companies fulfil their ESG due diligence obligation?

According to the Draft Directive, companies have to conduct due diligence with respect to human rights, environmental, and governance risks in their operations and business relationships. More specifically, companies need to assess, on an ongoing basis, whether their operations and business relationships cause, or contribute to, any human rights, environmental, or governance risks.

Any conclusive assessment that the company does not cause or contribute to any such risks would need to be made public and supported by a risk assessment. If the company identified risks, it would need to establish a due diligence strategy that:

- specifies the risks identified and their level of severity and urgency
- publicly discloses “detailed, relevant and meaningful information” about their value chain “including names, locations and other relevant information concerning subsidiaries, suppliers and business partners”
- indicates the policies and measures the company intends to adopt to prevent the identified risks
- establishes a prioritization policy if the company cannot deal with all the risks simultaneously
- indicates the methodology followed for the definition of the strategy, including the stakeholders consulted by the company

Once created, the effectiveness and appropriateness of the due diligence strategy needs to be reassessed at least once a year. The strategy must be made public (e.g., on the company’s website) and communicated to employees and business partners.

Finally, the Draft Directive requires companies to conduct due diligence with respect to their supply chain partners and regularly verify the compliance of their subcontractors and suppliers through relevant contractual provisions or codes of conduct.

Grievance mechanisms and remedies

The Draft Directive also imposes on companies the obligation to establish a grievance mechanism, allowing stakeholders to “voice concerns regarding the existence of human rights, environmental or governance risks.” Express reference is made to the criteria set out in Principle 31 of the [UN Guiding Principles on Business and Human Rights](#) in establishing a requirement that the grievance mechanisms should be legitimate, accessible, predictable, safe, equitable, transparent, rights compatible, and adaptable. Companies that have caused or contributed to harm should “provide for or cooperate with remediation,” which may include financial or nonfinancial remedies.

Who will be responsible for the due diligence process?

According to the Draft Directive, the responsibility for the ESG due diligence must be collectively carried by the administrative, management, and supervisory bodies of the company. However, managers or directors might be held individually liable for breaches of the due diligence obligation.

Large companies are expected to set up an advisory committee tasked with advising their governing body on due diligence, which would include stakeholders and experts.

Supervision and Investigations

The Draft Directive provides that companies are supervised by national authorities that have the power to carry out investigations to ensure compliance with the Directive. Investigations might be initiated based on third-party complaints, and member states might choose to enact additional rules to facilitate the submission of such complaints.

What penalties will be imposed on noncompliance companies?

While the Draft Directive explicitly provides for penalties for noncompliance, it remains silent on whether there would be civil-liability consequences for companies that have caused harm to third parties. In that regard, the Draft Directive goes less far than the initiative, which sought to introduce such liability of Swiss companies even for wrongdoings by their foreign affiliates and commercially dependent suppliers. That being said, conducting ESG due diligence in accordance with the Draft Directive would not per se absolve a company from civil liability under national law.

2. Recommendations to Clients

While the details of the final legislative proposal are still uncertain, Swiss companies are well advised to continue monitoring the development of this proposal. They should also consider making their voices heard.

Interested parties can submit their opinion to the commission before February 8, 2021. A template for the public consultation can be found [here](#).

Please contact us if you would like to discuss how we may support you in preparing for the challenges presented by this legal development.