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Legal Joint Paper

Corporate due diligence duties within the EU framework on sustainable corporate governance

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INTRODUCTION

2011 OECD Guidelines for Multinational Enterprises refer to corporate due diligence as the process through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse impacts as an integral part of business decision-making and risk management systems.

Although there are many international benchmarks that companies can refer to in relation to the principles and practicalities of conducting corporate due diligence ([1]), there is currently no common legislation at EU level identifying general due diligence obligations, also in relation to the value chain. Indeed, the Non-Financial Reporting Directive (Directive 2014/95/EU - "NFRD", amending Directive 2013/34/EU) requires "public-interest entities" ("PIE") ([2]) exceeding, individually and/or at group level, certain dimensional criteria ([3]), to include in the non-financial statement information on the due diligence processes implemented, "*to the extent necessary for an understanding of the undertaking's development*". However, the NFRD does not detail the reporting requirements of due diligence procedures, nor does it set out how they should be conducted ([4]).

In the light of the above, although a study highlighted that close to 45% of all surveyed companies within the scope of NFRD have implemented new due diligence processes on environmental or human rights matters as a consequence of the reporting obligations set forth in NFRD ([5]), several demands for review and [amendment/expansion] of the European framework on corporate due diligence have emerged ([6]).

On 11 December 2019, within its communication on the European Green Deal, the European Commission announced its intention to review the NFRD as part of the strategy

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([1]) *E.g.*, in addition to the 2011 OECD Guidelines for Multinational Enterprises, the 2011 United Nations Guiding Principles on Business and Human Rights (UNGPs); the 2012 United Nations Global Compact, Save the Children and UNICEF Children's Rights and Business Principles; the 2013 UN Committee on the Rights of the Child General Comment No. 16; the recommendation CM/Rec(2016)3 of the Committee of Ministers to member States on human rights and business adopted on 2 March 2016; the 2018 OECD Due Diligence Guidance for Responsible Business Conduct; the 2017 ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy.

([2]) "Public-interest entities" means undertakings which are: (a) governed by the law of a Member State and whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point (14) of Article 4(1) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments; (b) credit institutions as defined in point (1) of Article 4 of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, other than those referred to in Article 2 of that Directive; (c) insurance undertakings within the meaning of Article 2(1) of Council Directive 91/674/EEC of 19 December 1991 on the annual accounts of insurance undertakings; or (d) designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees.

([3]) *I.e.* those PIE having, individually and/or at a group level, an average of at least 500 employees during the financial year and which, as of the balance sheet date, have exceeded at least one of the two following size limits: (a) balance sheet total: Euro 20,000,000; (b) net turnover: Euro 40,000,000.

([4]) However, it should be noted that the NFRD was supplemented by the European Commission 2017 Guidelines on non-financial reporting (2017/C 215/01) which, whilst not binding, established for the first time a common European approach to the content of corporate due diligence disclosures.

([5]) CEPS Study on the Non-Financial Reporting Directive – Final Report, November 2020, 114; however, the study pointed out that it is very difficult to disaggregate the effect of the NFRD from other factors that may drive changes in company policies and behavior.

([6]) For instance, in March 2019 the Responsible Business Conduct Working Group of the European Parliament presented its Shadow EU Action Plan on the implementation of the UNGPs, calling, amongst other things, for the adoption of mandatory due diligence for EU businesses and business operating within the EU. On 3 October 2019, over 80 NGOs and trade unions published a call on the European Commission "*for effective EU legislation that establishes a mandatory human rights and environmental due diligence framework*". In November 2019, the European Network of National Human Rights Institutions (ENNHRI) issued a statement to the new European Commission which recommends the development [and] adoption of an EU-level Action Plan on Business and Human rights which should include measures on a "*European Human Rights Due Diligence legislation*".

to strengthen the foundations for sustainable investment. A public consultation, launched between February and June 2020, identified several shortcomings in the implementation of the NFRD, also relating to the content of corporate due diligence reporting requirements: the proposed review of the Directive (which will then be referred to as the Corporate Social Responsibility Directive – "CSRD") will therefore require in-depth description of the due diligence process implemented, the adverse impacts connected with the company's value chain, any actions taken and the result of such actions.

The CSRD proposal is also closely coordinated with other Commission initiatives, including in particular the "Sustainable corporate governance initiative", aiming at embedding sustainability in the corporate governance framework and fostering behavioral change in companies by addressing issues such as due diligence for environmental and human rights impacts ([7]). With the aim of influencing such initiative, on 10 March 2021 the European Parliament adopted a legislative own initiative resolution recommending to the Commission to initiate a legislative proposal on corporate due diligence and corporate accountability. Such resolution notes that, whereas the Union has already adopted due diligence legislation for specific sectors – such as the Conflict Minerals Regulation, the Timber Regulation, the Forest Law Enforcement, Governance and Trade (FLEGT) Regulation and the Anti-Torture Regulation – the lack of a joint Union-wide approach may lead to less legal certainty when it comes to business prerogatives and to imbalances in fair competition, which would in turn disadvantage undertakings that are proactive regarding social and environmental matters.

In the annex to the resolution, the European Parliament proposed a draft directive which, *inter alia*: (i) provides for the obligation of Member States to establish rules requiring large companies and publicly listed and high-risk companies to conduct effective due diligence regarding potential or actual adverse impacts of their operations, value chains ([8]) and business relationships on human rights, the environment, and good corporate governance; (ii) requires companies to publicly disclose their due diligence strategy, engage with stakeholders and implement an adequate grievance mechanism that stakeholders can use to voice their concerns, and provide means of remediation for harm done; (iii) requires Member States to establish an adequate supervision system and provide for proportionate sanctions, within the ordinary civil liability regime.

Considering the above, the purpose of this joint paper is to provide, in the light of the evolving European regulatory scenario, an overview of the current and potential *status* of legislation and case law in France, Germany, Italy and Spain.

([7]) See https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance_en.

([8]) Meaning all activities, operations, business relationships and investment chains of an undertaking, including entities with which the undertaking has a direct or indirect business relationship, upstream and downstream, and which either: (a) supply products, parts of products or services that contribute to the undertaking's own products or services, or (b) receive products or services from the undertaking.

FRANCE

1. What rules apply to corporate due diligence?

The Law n°2017-399 dated March 27, 2017 on the Duty of Vigilance of parent companies (*Loi relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre*) created the obligation, for companies meeting certain thresholds (see point 2.) to draw up an effective Duty of Vigilance plan (hereinafter the "Plan"). Companies must publish their Plan in their annual management report.

These companies, regardless of their activities or revenues, are required to establish and implement a Plan, which must contain measures to identify relevant risks, and prevent serious impacts:

- on human rights and fundamental freedoms,
- on the health and safety of persons, and
- on the environment.

The Law does not provide for a definition of these notions. Parliamentary works preceding the adoption of the Law refer to French constitutional norms and European and international conventions including:

- The Universal Declaration of Human Rights of December 10, 1948;
- The International Covenant on Civil and political Rights of December 16, 1966;
- The European Convention on Human Rights November 4, 1950;
- The Charter of Fundamental Rights of the European Union December 7, 2000.

Scholars also suggest referring to OECD Guidelines for Multinational Companies, the UN Guiding Principles on Human Rights and the Tripartite declaration of principles concerning multinational enterprises and social policy.

Before this law was enacted, French companies did not have any specific legal obligations in terms of duty of vigilance. However, certain laws or regulations indirectly encouraged companies to adopt and implement due diligence policies and procedures in the fields of environment and human rights. First, and even before the NFRD was implemented in France in 2017 by the ordinance n° 2017-1180 of July 19, 2017, French companies meeting certain criteria had to publish non financial information on a yearly basis in their annual report. Since the implementation of the NFRD, French public interest entities, but also some other types of French companies, in particular non listed companies with more than 500 employees and either a balance sheet total of more than Euro 100 million or a net turnover of more than Euro 100 million, must include in their annual management report a non-financial performance statement (*déclaration de performance extra-financière* or "*DPEF*") which addresses how the company takes into account the environmental and social consequences of its activities. Reference can be made in the DPEF to the Plan established pursuant to the Duty of Vigilance Law.

In 2005, an environment charter (*Charte de l'Environnement*) was incorporated to the French Constitution, pursuant to which any person, including companies, shall participate in the preservation and improvement of the environment.

Finally, on May 22, 2019, the French Parliament adopted the PACTE Law which, among other things, amended selected provisions of the French Civil and Commercial Codes to expressly address consideration of social and environmental issues in the management of French companies. More specifically:

- Articles 225-35 and 225-64 of the French Commercial Code were amended to state that corporate and management boards must consider social and environmental issues in relation to their managerial duties.

- Article 1833 of the French Civil Code was amended to indicate that corporations must be managed in their own corporate interests, not just those of their shareholders, taking into consideration social and environmental issues that relate to their business operations. Although this provision is construed as an obligation to examine these issues in the decision-making process, and not necessarily to opt for the most socially - or environmentally - friendly option, it is seen as reinforcing the duty for the management to put in place adequate processes in the company to identify, assess and conduct analysis of the social and environmental impact of their decisions.

- Article 1835 of the French Civil Code was amended to permit corporations to include in their bylaws a “fundamental purpose” or “raison d’être”, consisting of the justification of the corporation’s contribution to society, to be taken into consideration in the conduct of its business. Adopting a raison d'être enhances the duty for the management of the company to ascertain that the company complies in its strategy and operations with certain principles, at least those included in its raison d'être.

- Article L210-10 of the French Commercial Code also permits companies to use the newly created label of "mission led companies" (*société à mission*), provided they adopt a raison d'être, set one or more social or environmental objectives in furtherance thereof and create a mission committee that verifies the pursuit of these objectives by the company. Adopting this label also reinforces the above mentioned obligation.

2. What is the scope of the regulation?

The French Corporate Duty of Vigilance Law only applies to companies:

- whose head office is in France and which have at least 5,000 employees in France (directly or employed by their subsidiaries); or

- whose head office is in France, and which have at least 10,000 employees globally (directly or employed by their subsidiaries),

which have a legal form of *sociétés anonymes, sociétés en commandite par actions or sociétés par actions simplifiées*, even if they are subsidiaries of a foreign company.

According to the Law, the Plan must cover risks that may arise from the operations of the company, and from any companies it controls.

The Plan shall also identify risks arising from the operations of subcontractors and suppliers with whom the company has an established commercial relationship, where these operations derive from this relationship.

3. What measures and best practices can be adopted to implement corporate due diligence duties?

The Plan includes the following measures:

- a mapping document identifying, analyzing and ranking the risks;
- procedures to assess the situation of the company's subsidiaries, subcontractors and suppliers in view of these risks;
- appropriate actions to mitigate risks and prevent serious violations;
- a whistleblowing and reporting mechanism focusing on these risks; and
- a monitoring scheme to assess the efficacy of measures implemented.

Apart from these obligations resulting from the Duty of Vigilance Law, the increasing importance of ESG issues has led many companies to adopt best practices such as creating a specific CSR or ESG committee at board level, creating a committee of stakeholders to improve the dialogue between the company and its stakeholders, defining appropriate KPIs and improving risk management processes, allocating resources to the training of employees and directors and including non financial criteria in the top management variable remuneration. This also includes adopting an ethics code, and inserting in contracts with suppliers or subcontractors appropriate provisions or have them sign a charter whereby they undertake to comply with various principles in terms of environment, health, social and human rights.

4. What are the enforcement measures and consequences in case of violation?

In the event of a failure to draft, publish or effectively implement its Plan, any individual or legal entity with a "legitimate interest" may give the company formal notice to comply with its obligations. At the end of a three-month period following the formal notice, if the company has failed to comply with its obligations, the court may order it to do so under penalty.

The company's civil liability may also be engaged, for failure to comply with the provisions of the Duty of Vigilance Law. Courts may order the company to compensate for the harm that would have been avoided by performance of the vigilance obligations.

There have been, to our best knowledge, five actions initiated before French courts against companies on the basis of the Duty of Vigilance Law, all of which are still ongoing. The five actions aim at compelling the companies to comply with their duty of vigilance and one also seeks the civil liability of the company. These actions are fairly recent and no decision on the merits has been rendered yet.

For example, a French Energy Group is being sued on the allegation that it has not consulted nor obtained informed consent from the indigenous community affected by the company’s planned wind farm project in Mexico. The lawsuit seeks suspension of the company's wind farm until it complies with its duty of vigilance. A French retail Group is being sued on the basis of alleged violations with respect to the company’s supply chain practices including purchasing from farms involved in deforestation in South America. A lawsuit has also been brought before the court against a French oil company, on the basis that it would be failing to limit its carbon emissions or to mitigate the effects of climate change caused by its operations, and that its climate change plan would fall short of the goals set out in the 2015 Paris Agreement.

More recently, the French Law n° 2021-1104 dated August 22, 2021 known as the "Climate Law" recently introduced a new sanction. The law provides for the exclusion of companies in breach of their vigilance obligations from specific public procurement proceedings. These provisions have not, however, entered into force as the implementation decree allowing it has not been published yet.

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GERMANY

1. What rules apply to corporate due diligence?

Currently, corporate due diligence is regulated only in highly specific industries (.e.g., the EU Timber Regulation and the Conflict Mineral Regulation and the respective transformation acts in Germany). However, in 2021, the German Parliament passed the **Supply Chain Act** (*Lieferkettensorgfaltspflichtengesetz*), which will come into force on 1 January 2023. It addresses negative impacts on human and environmental rights caused by global supply chains.

The overall *ratio* of the Supply Chain Act is to prevent human rights or environmental risks and to stop the violation of human rights or environmental obligations.

Generally speaking, the Supply Chain Act requires companies to make appropriate efforts to secure that there are no violations of specific human or environmental rights in their own business operations and in the supply chain. Obligations under the Supply Chain Act are mere "best effort obligations", i.e., they do not require companies actually to achieve prevention of human rights violations, but **to do their best to prevent** such violations.

A human rights or environment related obligation is violated if one of the following prohibitions has been breached;

- Employee protection
  - Prohibition of child labour,
  - prohibition of the employment of persons in forced labour and prohibition of slavery,
  - prohibition of disregard for occupational health and safety,
  - prohibition of disregard for freedom of association,
  - prohibition of unequal treatment in the employment relationship and
  - prohibition of the withholding of a fair wage.

- Protecting of livelihoods
  - Prohibition of contamination of soil, air and water and
  - prohibition of unlawful eviction.

- Protection against the use of security forces
  - Prohibition of the use of security forces that, in the absence of instruction or control, violate the prohibition of torture, inflict injury to life, or interfere with the freedom of association and freedom of organization.

- General clause
  - Serious violations of other legal positions protected under the ICCPR, the ICESCR and under Core Conventions of the ILO.

- Environmental-related prohibitions
  - Prohibition of the production of mercury-added products and the use of mercury in manufacturing processes,
  - prohibition of the production and use of certain chemicals, and
  - prohibition against export and import of poisonous waste.
  - There is no general clause regarding the protection of legal positions protected under environmental treaties.

These prohibitions are based on international treaties, such as the International Covenant on Civil and Political Rights (**ICCPR**), the International Covenant on Economic, Social and Cultural Rights (**ICESCR**), the Core Conventions of the International Labour Organization (**ILO**) with regard to human rights and, on the other hand, the Stockholm Convention or the Basel Convention with regard to environmental rights.

In order to achieve the purpose of the Supply Chain Act – prevention of human rights and environmental risks in supply chains – the Supply Chain Act provides for a number of **due diligence obligations** for companies. Such due diligence obligations can include the implementation of risk-analysis systems (see a.), prevention/remedial-measures (see b.), a risk-management (see c.), compliance with documentation and reporting obligations (see d.) as well as the establishment of a complaints procedure (see e.).

The Supply Chain Act implements a "tiered" system of due diligence obligations. The obligations apply without restriction to the company's own business operations and to direct suppliers (so-called "tier 1 suppliers"). The due diligence obligations apply to a limited extent to indirect suppliers (so-called "tier 2 suppliers") (see f.).

a. Risk analysis and risk management

Companies have to implement appropriate risk management and risk analysis processes in their business operations. As the basic step of their corporate due diligence system, they have to conduct a risk analysis to determine which measures they have to take in order to ensure compliance with the prohibitions set out in the Supply Chain Act. Such risk analysis has to be carried out on an annual basis and when appropriate (i.e., in relation to the occurrence of events that disclose new or increasing risks).

In this regard, the legislator proposes a two-step procedure: Firstly, it will usually be appropriate to cluster risk factors within a company's business operations categories, e.g., business areas, locations, (countries of origins of) products or political framework conditions. Secondly, detected risks should be evaluated and prioritized based on nature and scope of the anticipated risk.

b. Human rights declaration

In addition, companies have to adopt a human rights declaration on their overall human rights strategy. This human rights declaration has to be issued by the management of the company.

c. Preventive measures/remedial measures

Once risks have been detected, companies have to take appropriate preventive and remedial measures, that in the best case end the violation. For example, on the basis of the Supply Chain Act, violations of direct suppliers can oblige companies, as *ultima ratio*, to terminate their business relationship and their respective agreements. Typical measures to prevent such violations would be, e.g., the implementation of codes of conduct, the selection of reliable suppliers and ongoing supplier monitoring, or the implementation of training courses. In addition, it is material for the prevention or remediation of human rights risks to appoint a human rights officer.

d. Documentation and reporting requirements

Companies are subject to an **internal documentation obligation** and an **external reporting obligation**. The purpose of such due diligence obligations is to enable the competent authority to monitor compliance with the provisions of the Supply Chain Act.

First, companies are obliged to issue a declaration of principles which defines the corporate human rights strategy. They are also obliged to document internally whether and how they fulfil their due diligence obligations. This is accompanied by an obligation to retain the relevant documentation for a period of at least seven years. Finally, companies must publish an annual report on the company's website on existing human rights and environment related risks and whether supply chain obligations have been violated. The report also has to describe preventive and remedial measures companies have taken and evaluate the effectiveness of such measures. However, in doing so, companies are not obliged to disclose business and trade secrets.

The report shall be submitted to the Federal Office of Economics and Export Control.

e. Complaints procedure

Companies have to implement an appropriate complaints procedure (including respective rules of procedure) internally or can make use of external complaints systems and grant access to such complaints procedure in a comprehensible and barrier-free manner. In addition, the Supply Chain Act provides that whistleblowers enjoy confidentiality and must not become the victim of reprisals.

f. Implications regarding inidirect suppliers

As mentioned above, the Supply Chain Act provides for a “tiered” system of obligations. Therefore, due diligence obligations are less strict with regard to indirect suppliers compared to direct suppliers. In particular, the company merely has to carry out a risk analysis and initiate preventive or remedial measures in case there are factual indications that a human rights obligation or environmental obligation has been violated. Most importantly, companies do not have to identify any risks preventively. The specific preventive and remedial measures companies have to take regarding indirect suppliers are also less strict than those in its own business area or regarding direct suppliers. The termination of business relations, for example, is not compulsory regarding the supply chain relationship with indirect suppliers.

2. What is the scope of the regulation?

Companies having their head office, administrative seat or statutory seat in Germany or companies that have a branch office in Germany are included within the scope of application of the Supply Chain Act. In addition, certain headcount thresholds have to be met, i.e., from 1 January 2023 companies with at least 3,000 employees and from 1 January 2024 companies with at least 1,000 employees are subject to the Supply Chain Act. Group companies are included within the calculation of employees.

Even though companies with fewer employees are not directly addressed by the Supply Chain Act, they may still be affected, since large companies will be obliged to pass on their obligations under the Supply Chain Act to other business partners in the upstream supply chain. Suppliers that are economically dependent on large companies will in practice have to accept their terms and conditions and / or their code of conduct in order to maintain their business relationship.

According to the German government, it is expected that the Supply Chain Act will (directly) cover approximately 2900 companies from 2024 onwards.

3. What measures and best practices can be adopted to implement corporate due diligence duties?

As the Supply Chain Act has not yet come into force, it naturally is too early to speak of best practices. Therfore, best practices may evolve after the Supply Chain Act comes into force. In addition, administrative rules or guidelines will be introduced by the competent authorities in order to put the often vague provisoins of the Supply Chain Act into more concrete terms. However such administrative rules or guidelines have not yet been published. In addition, the Supply Chain Act explicitly obliges the Federal Office of Economics and Export Control to support companies in complying with the due diligence obligations and providing such support.

Nonetheless, taking into consideration that the Supply Chain Act will enter into force rather soon and the implementation of processes may take considerable time, companies are recommended to prepare to implement the following measures:

- Implementation of a risk analysis and risk management system (see 1. a.),
- Investigation and evaluation of existing contracts, especially with tier one suppliers, including possible renegotiation of certain clauses or even contracts,
- examination of internal company guidelines and processes,
- appointment of a human rights officer,
- implementation of a code of conduct or terms and conditions that guarantee compliance with the Supply Chain Act and
- drafting of a declaration of principles concerning the company's human rights strategy (see 1. d.).

4. What are the enforcement measures and consequences in case of violation?

The Supply Chain Act expressly states that it does not intend to set out new claims for civil law liability apart from general civil law principles (see a.). The legislator emphasises that the central instruments to enforce the Supply Chain Act shall be administrative and administrative offence law. Accordingly, the Supply Chain Act provides for extensive administrative enforcement mechanisms by the authorities (see b.) and postulates a strict sanctions regime (see c.).

a. Civil enforcement

The Supply Chain Act provides that a breach of the obligations under this Act shall not give rise to civil liability. However, civil liability established independently of this Act is expressly unaffected.

Civil law actions could firstly come from customers claiming a material defect, challenging sales contracts due to fraudulent misrepresentation or asserting claims arising from pre-contractual liability. Secondly, claims in relation to suppliers are conceivable, e.g. recourse claims for reputational damage on a contractual basis or contractual termination rights in the

event of violations. Thirdly, competitors could sue for injunctive relief, removal and damages due to inaccurate reporting. Finally, claims by third parties are conceivable, especially from general tort liability if corresponding duties of care have been violated.

Violations of obligations under the Supply Chain Act can be brought in front of German courts. However, since the facts of the case regularly cross national borders, the question arises as to the applicable law. The relevant conflict of laws rule for claims under tort law is in principle Article 4 of the Rome II Regulation. This means that the law of the country in which the damage occurred, is generally applicable.

The Supply Chain Act provides that a person who claims to have been injured in a preponderantly protected legal position may authorise a domestic trade union or non-governmental organisation to bring proceedings to enforce his rights. This is particularly important against the background of a growing "claims industry" in Germany. This often works according to the business model of "no risk but chance" approach - collecting fees via legal expenses insurance, whereby the prospects of success are often of secondary importance. The costs and effort for the defence in such cases can be enormous and even if the lawsuit is dismissed, there is only partial compensation on a small scale. Examples include the automotive industry (exhaust emissions), cartel violations, interest claims against credit institutions, misinformation on the capital market, revocation clauses of car financing loans, etc.

b. Administrative enforcement

The competent authorities investigate human rights violations *ex officio* or upon application of affected persons. Therefore, the authorities monitor the annual human rights reports of companies as a starting point (see 1. d)).

In case of detected incidents of non-compliance with the Supply Chain Act, authorities are entitled to order improvement measures and, specifically, may issue orders to prevent or remedy breaches of due diligence (while having broad discretion to determine individual measures), enter company premises or order the disclosure of certain documents to gather information in this regard.

Therefore, the enforcement mechanism of the Supply Chain Act combines instruments of administrative control and private self-control.

c. Sanctions regime

The Federal Office of Economics and Export Control can impose fines if companies have not or not sufficiently observed the due diligence requirements. Negligence is sufficient to constitute an infringement. Companies may face administrative fines of up to Euro 8 million or up to 2% of the company's worldwide annual turnover. Serious non-compliance may also result in exclusion from public procurement for a maximum period of three years.[9] The respective company will also be added to the German competition register. Thus, the affected company can no longer enter into agreements with public sector partners. This can lead to a severe loss in profit and sales, dependent on the customer structure of the affected company.

[9] The exclusion from public procurement requires a legally established violation with a fine of at least Euro 175,000.

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ITALY

1. What rules apply to corporate due diligence?

Italian law does not establish a specific notion of corporate due diligence nor does it expressly envisage a mandatory due diligence process. However, many legal provisions, albeit indirectly, may encourage companies to adopt and implement due diligence policies and procedures.

Legislative Decree No. 254/2016 on the communication of non-financial information transposes the NFR Directive and, consistently with the European regulation, requires public-interest entities to disclose their policies on environmental and social matters, regarding employees, human rights, anti-corruption and bribery, including also a description of the policies and practices adopted in relation to due diligence processes, albeit without setting out the required detail of their content. Therefore, a benchmark for the implementation of the duty of corporate due diligence is represented by the non-binding reporting standards and guidelines, such as the GRI Standards, the UN Guiding Principles Reporting Framework, the European Commission 2017 Guidelines on non-financial reporting (2017/C 215/01) and the various OECD Guidelines.

Such guidelines provide principles and concrete examples that companies may refer to when implementing and disclosing their due diligence processes. In 2011, the OECD National Contact Point ("NPC") – i.e. the body created by the Italian Government under Law No. 273/2002 to ensure that the OECD Guidelines for Multinational Enterprises are applied in Italy –developed a "Guide to due diligence in the supply chain", with the aim of putting into practice the indications on due diligence contained in the OECD Guidelines and facilitating companies, especially small and medium-sized enterprises, to assess and prevent the risk of negatively affecting the values protected by the OECD Guidelines (human rights, environment, competition, etc.). However, considering the non-binding nature of these standards, the implementation of general due diligence processes is still at an early stage: for instance, according to a recent study, the number of companies that claim to have involved their suppliers in the reduction of environmental impact in Italy does not exceed 10% (10).

An important set of rules that may lead companies to adopt due diligence procedures is Legislative Decree no. 231/2001 ("231 Decree"), governing corporate liability in Italy for certain specified crimes (e.g., bribery, private corruption, manslaughter or bodily injuries caused by negligence of health and safety regulations in the workplace, workers' exploitation, environmental crimes) where those crimes are committed in the interest or to the benefit of a corporate entity by its directors, officers, representatives or employees under their surveillance (11).

([10]) See Consob Call for evidence (26 October 2020), N. LINCIANO, *Sostenibilità e non-financial reporting - Lo stato dell'arte in Italia*.

([11]) Legislative Decree no. 231/2001 does not explicitly include within its scope corporate groups. However, according to the Italian case-law, parent companies can be held responsible for crimes committed within their subsidiaries if the person committing the crime in the latter was also acting on behalf of the parent company and pursuing its interests or a person acting on behalf of the former participated in the crime by providing a contribution to it, including ever merely by providing ideas, suggestions, et. al. (see Court of Cassazione, 20 June 2011, No. 24583).

For corporate entities not to be held liable under 231 Decree in case one of the foregoing crimes is committed in their interest or to their benefit, their management must have adopted, effectively implement and keep up to date an Organization, Management and Control Model setting out anti-crime protocols ("231 Model") and a Supervisory Body ("Organismo di Vigilanza") must have been appointed to monitor and ensure the company's compliance with it: although the adoption of a 231 Model is not mandatory *per se*, it does however represent the most effective means for avoiding the relevant corporate criminal liability as a demonstration by the company that a compliance system had indeed been implemented in order to prevent crimes of the type occurring (i.e., that there was not a deficiency in their organization in this regard) (12). In this respect, 231 Decree itself does not expressly require the exercise of due diligence on suppliers or human rights and environmental impacts nor more generally does it provide for specific contents which 231 Models should have, but only creates the framework for companies to create a defense against corporate criminal liability: in this respect, the implementation of due diligence procedures can form part of wider anti-crime protocols adopted under a 231 Model.

The 2016 Stability Law (Law No. 208 of 28 December 2015) also introduced in the Italian legal system an innovative discipline of the so-called "benefit companies", a specific model of a profit-making company with the obligation to develop a sustainability strategy, operating in a responsible, sustainable and transparent way towards people, communities, territories and the environment. Although not subject to specific due diligence requirements, benefit companies must be managed in such a way as to balance the interests of shareholders, the purposes of common benefit and the interests of other stakeholders, thus balancing profit-making interests with the purposes of common benefit.

It should also be noted that there are various sector regulations, including those at regional and municipal level, that govern the exercise of business activities in relation to environmental, social and human rights issues, which could lead companies to adopt specific due diligence processes. One national level example is Legislative Decree No. 81/2008 (TULS Decree) which covers the areas of health and safety at work. The TULS Decree does not expressly refer to due diligence, but requires all public and private Italian companies to draft and update a formal "Risk Assessment Document" containing, inter alia, details of all risks related to health and safety at work, the measures of prevention and protection implemented and the procedures for the implementation of security measures.

Lastly, it should be noted that the Italian Government, under its 2016 National Action Plan on Business and Human Rights, committed, inter alia, to promote a shared understanding of the concept of due diligence and strongly encourage companies to become active in establishing human rights policies and activating due diligence processes throughout the supply chain (13). In this regard, recently over 50 academics and experts published an open letter addressed to the Italian institutions stating that "the time is ripe for Italy to start a policy process towards the adoption of effective legislation on human rights due diligence, in line with its international obligations and with the positive example of other European countries" (14).

([12]) Please note that on 30 July 2018 a law proposal was submitted to the Presidency of the Italian Senate (*Disegno di legge n. 726*) aimed at making it compulsory for larger companies to adopt a 231 Model.

([13]) The National Action Plan has recently been placed under public consultation by the Interministerial Committee for Human Rights, in order to collect comments and proposals from various stakeholders, in view of the definition of the second National Action Plan on Business and Human Rights 2021-2026.

([14]) https://media.business-humanrights.org/media/documents/files/Open_letter_BHR_English.pdf, 11 November 2019.

2. What is the scope of the regulation?

Consistently with the NFRD, Legislative Decree No. 254/2016 applies exclusively to public-interest entities – i.e. Italian companies whose transferable securities are admitted to trading on a regulated Italian or EU market, credit institutions, insurance and reinsurance companies – having, individually and/or at a group level, an average of at least 500 employees during the financial year and which, as of the balance sheet date, have exceeded at least one of the two following size limits: (a) balance sheet total: Euro 20,000,000; (b) total net turnover from sales and services: Euro 40,000,000 ([15]).

As for Legislative Decree no. 231/2001, the regulation applies to entities with legal personality, companies and associations (also without legal personality) for crimes committed in their interest or to their benefit:

a) by persons who hold representative, administrative or managerial positions in the entity or in one of its organizational units with financial and functional autonomy, as well as by persons who exercise, also de facto, the management and control of the entity;

b) by persons subject to the management or supervision of one of the persons mentioned in letter a).

With regard to the TULS Decree on health and safety at work, the Risk Assessment Document is mandatory for all companies that have at least one employee or one collaborator.

3. What measures and best practices can be adopted to implement corporate due diligence duties?

As mentioned above, both the NFRD and Legislative Decree No. 254/2016 only provide for a disclosure obligation. However, despite due diligence in this context being mainly about reporting, companies – also in order to ensure an effective disclosure – may anyway implement due diligence processes into broader enterprise risk management systems, as recommended for instance by the OECD Due Diligence Guidelines for Responsible Business Conduct ("RBC"). In particular, such Guidelines recommend companies to adopt RBC policies in order to prioritize risks in conducting the corporate due diligence and approaching stakeholders, explaining why some risks are considered more significant than others and how the company intends to take action on its value chain and business relationships.

Furthermore, companies could implement due diligence standards in their value chain, by (i) including specific clauses in the supply agreements aimed at ensuring compliance with environmental and human rights related regulations and principles, (ii) implementing measures to control the work of suppliers and (iii) setting up an enforcement system to monitor the adequate preparation and implementation of procedures (16).

([15]) Based on the information available on Consob's website, as of 31 December 2020, 204 entities had published the non-financial statement.

([16]) In this regard, see Assonime, *Doveri degli amministratori e sostenibilità*, *Note e Studi 6/2021*, 18 March 2021, 33-34, according to which this discipline should only be addressed to *(i)* companies or groups of significant size having the economic power to impose contractual rules on their suppliers, and *(ii)* suppliers who are in a situation of economic dependency *vis-à-vis* large companies.

Another measure that companies could implement is the adoption of the 231 Model to minimize the risk of liability for bribery, private corruption, workers' exploitation, and environmental crimes. As mentioned above, although Legislative Decree no. 231/2001 does not expressly provide for a mandatory due diligence process, the adoption of a 231 Model requires that both a risk assessment activity be performed and protocols and decision-making processes be set so that the foregoing crimes can be prevented. This usually involves also the adoption by the company of a "code of conduct" or "code of ethics" bringing together all the values that the company recognizes and shares, as well as the responsibilities that it assumes, both inside and outside its organization (including relationships with public institutions, local communities, customers and suppliers).

In addition to other measures provided by sector regulations – including those specifically concerning state-owned companies and governing the assignment and management of public supply and service agreements – companies must also adopt a Risk Assessment Document in order to comply with the TULS Decree on health and safety at work. Such Document must identify and describe all the risks related to health and safety at work, as well as the prevention and protection measures and the procedures for implementing them.

4. What are the enforcement measures and consequences in case of violation?

With regard to non-financial information disclosure duties, Legislative Decree No. 254/2016 provides that a pecuniary administrative sanction ranging from Euro 20,000 to Euro 100,000 can be applied by Consob on directors of public-interest entities when, inter alia, the individual or consolidated non-financial statement filed with the Companies' Register does not comply with the Decree's requirements. The same penalty can be applied to members of the control body who, in breach of their supervisory duties, fail to report to the shareholders' meeting that the individual or consolidated non-financial statement does not comply with the above-mentioned requirements. If the statement contains material untrue facts or if it omits significant material facts, directors and members of the control body of the public-interest entity are subject to a pecuniary administrative sanction ranging from Euro 50,000 to Euro 150,000. Furthermore, other pecuniary administrative sanctions can be applied to external auditors who fail to comply with their certification duties.

In relation to non-financial information disclosure, a non-judicial dispute settlement mechanism is also envisaged under the OECD Guidelines for Multinational Enterprises, which allows the stakeholders who have been affected by a non-compliant behavior to bring the issue to the attention of the Italian National Contact Point ("NPC"). The NPC has the role of mediating between the parties to reach an agreement, adopting all the actions useful for dialogue and the settlement of the dispute.

As for Legislative Decree no. 231/01, the law sets out a range of sanctions in case one of the crimes entailing corporate liability is committed in the company's interest or to its benefit by the individuals indicated in para. 2 above and the company either had not adopted or had ineffectively implemented a 231 Model. In this connection, applicable penalties comprise: (i) monetary fines and (ii) forfeiture of the proceeds of the crime. Other sanctions, such as (iii) disqualification sanctions (such as debarment from carrying out the activity; suspension or revocation of authorizations, licenses or grants functional to the perpetration of the offence; prohibition on contracting with the public administration, except for obtaining a public service; exclusion from facilitations, financing, contributions or subsidies and possible revocation of those already granted; prohibition on advertising goods or services)

and (iv) publishing of the conviction judgement, may apply only if specifically provided for the relevant crime itself..

With regard to the sanctions envisaged under the TUSL Decree for failure to adopt or properly implement the "Risk Assessment Document", the employer is sanctioned with house arrest for between 3 and 6 months or with a fine ranging from Euro 2,792.06 to Euro 7,147.60 and with a fine ranging from Euro 2,233.65 to Euro 4,467.30, respectively.

In addition to the above-mentioned enforcement measures and sanctions, and to any other sanction provided by sector regulations, also civil liability cannot be excluded. Even though, to date, there is no known case law specifically concerning the violation of corporate due diligence duties, in some criminal and civil cases the lack of control on third party suppliers or the absence of adequate internal procedures has been used by Courts to establish the negligence and, correspondingly, the liabilty of companies' management.

For instance, in a recent case involving, inter alia, Ferrovie dello Stato S.p.A. in relation to the derailment of a train coach which caused the death of 32 people, the top management of the company was found liable for the crime of train wreck committed by negligence also for not having carried out appropriate checks relating to the maintenance history of the wagons provided by foreign suppliers. Indeed, according to the Supreme Court if proper controls had been diligently carried out on suppliers, top management would have found that there were previous incidents related to the supplied coaches, which should have led to a change in the supply strategy and maintenance activities (17).

Given these established principles of the Italian legal system, it is reasonable to envisage that the introduction of new obligations on corporate due diligence might lead to an extension of the potential liability for sanctions and damages, the scope of which will be defined also in the light of the experience acquired and of any case law.

([17]) See Supreme Court (*Corte di Cassazione*), Criminal Section (Sez. IV), ruling 7 September 2021, no. 32899. More in general, it is also worth recalling some Italian case law related to environmental damages and work safety: *(i)* Ikebiri Community v. ENI and NAOC: civil proceedings started by Timi (as a representative of the Nigerian Ikebiri community) claiming breach of human and environmental rights against ENI (an Italian state-owned energy company) and NAOC (ENI's Nigerian subsidiary). The lawsuit was based on the rupture of oil pipelines, which affected the community's life and damaged wildlife and vegetation. The trial began before the Court of Milano and ended in 2019, following a confidential settlement agreement between the Ikebiri community and NAOC (supported by ENI); *(ii)* the ILVA case (so-called "Ambiente svenduto"): on 31 May 2021, the First-Instance Court of Taranto sentenced to jail several former managers of ILVA for the crimes of environmental disaster, manslaughter, and fraudulent failure to implement safety precautions at work in relation to the effects of toxic emissions from the ILVA steelworks in Taranto. Pursuant to Legislative Decree no. 231/01, the Court also imposed a Euro 4 million fine on ILVA, and ordered the forfeiture of ILVA's facilities for the crime of environmental disaster as well as the forfeiture of the proceeds of the crime amounting to Euro 2.1 billion . The case was also submitted before the European Court of Human Rights (*Cordella and Others v. Italy (applications nos. 54414/13 and 54264/15) ECHR (2019)*), which concluded that the entire population was living in an area at risk and that the applicants had not had available an effective remedy enabling them to raise with the national authorities their complaints concerning the fact that it was impossible to obtain measures to secure decontamination of the relevant areas; *(iii)* the ThyssenKrupp case: Italian Courts recognized the company's liability pursuant to Legislative Decree no. 231/2001 in relation to the fire which occurred at the Turin steel plant in December 2007, in which seven workers lost their lives. The final ruling of the Court of Cassazione concluded that the entity was liable also in light of the inadequate implementation of the 231 Model at the time of the accident.

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SPAIN

1. What rules apply to corporate due diligence?

Spain does not have a specific law for corporate due diligence on human rights and the environment although the Regulatory Plan for 2022 foresees its enactment.

However, Spanish companies are directly or indirectly obliged to fulfill corporate due diligence standards in managing and governing the effect their activity has on human rights and the environment, particularly those provided in the following EU or Spanish regulations:

(i) Spanish Criminal Code.
(ii) Spanish Companies Act.
(iii) Good Governance Code of Listed Companies.
(iv) Act 11/2018, on disclosure of non-financial and diversity information.
(v) Taxonomy Regulation (2020/852/EU) and its delegated acts.
(vi) SFDR Regulation (2019/2088/EU).

2. What is the scope of the regulations?

(i) The **Spanish Criminal Code** regulates corporate criminal liability and the resulting duties to prevent criminal offenses (compliance systems), particularly for acts involving corruption, bribery, money laundering, tax and environmental offenses, public health, human trafficking, and the sexual exploitation of children. This has generated compliance systems within corporations to manage the risks of criminal liability.

(ii) The **Spanish Companies Act** ("SCA") is addressed to Spanish public limited companies (SA)—including listed and unlisted companies—and Spanish private limited companies (SL). The SCA provides that:

- Directors' remuneration must be "*designed to promote the long-term profitability and sustainability of the company"*.

- In listed companies, (a) the sustainability policy must be approved by the board of directors as a whole and (b) the remuneration policy for directors must guarantee sustainability in the long term and must identify the objectives linked to variable remuneration, including social responsibility criteria.

(iii) The **Good Governance Code of Listed Companies** is addressed to Spanish listed companies, and it includes a set of recommendations for good governance (*soft law*). The code is based on the principle of voluntary compliance, subject to the rule of "comply or explain," where a listed company can choose whether to apply a given recommendation but is obliged to inform the market and explain the reasons for its decision.

The code understands that the board of directors "*should be guided at all times by the company's best interest, understood as the creation of a profitable business that promotes its sustainable success over time, while maximizing its economic value*."

In pursuing the corporate interest, the board of directors should "*strive to reconcile its own interest with the legitimate interests of its employees, suppliers, clients and other stakeholders, as well as the impact of its activities*" (Recommendation 12).

Given the importance of topics related to sustainability and social and environmental aspects or corporate governance, listed companies are encouraged to identify and assign specific functions in this area to a special committee (which could be the audit committee, the nomination committee, a sustainability or corporate social responsibility committee, or another *ad hoc* committee), or to split those functions between several committees (Recommendation 53). The code suggests a list of the functions that can be assigned to those committees (Recommendation 54).

(iv) **Act 11/2018** incorporates the Non-financial Reporting Directive (2014/95/EU) and requires that large companies provide a report on non-financial information, which must be put to shareholder vote as a separate point in the annual general meeting. Specifically, this obligation affects companies with more than 250 employees that:

- are considered public interest entities under the legislation on auditing of accounts (except entities that qualify as small and medium-sized companies under Directive 34/2013/EU); or

- meet, on the closing date of each of them, at least one of the following circumstances: (a) total assets exceed Euro 20,000,000; or (b) net amount of the annual turnover exceeds Euro 40,000,000.

Content of the non-financial information includes corporate due diligence procedures. The report must describe the following:

- The corporate business model (business environment, organization and structure, markets in which the entity operates, objectives and strategies, and main factors and trends that may affect its future evolution).

- The corporate policies and the results of due diligence procedures, including non-financial key performance indicators to enable the monitoring and evaluation of progress and to promote comparability between companies and sectors, using as a basis reference frameworks such as the UN Guiding Principles for company and human rights and the OECD Guidelines for Multinational Corporations.

- Environmental impacts; social and personnel-related impacts (comprising aspects such as the "wage gap" and the implementation of labor disconnection policies); respect for human rights; fight against corruption and bribery; and social contribution and impacts. This information must include not only company commitments to sustainable development, but also the management of subcontracting and suppliers, impacts on consumers, and tax policies.

The information on the non-financial key performance indicators must comply with the European Commission guidance and must be verified by an independent provider. It must be made available to the public free of charge and be easily accessible on the company's website within six months after the date of the end of the financial year and for a five-year period.

(v) **EU Taxonomy Regulation** and its delegated acts are intended to provide business and investors with a common language to identify whether an economic activity is environmentally sustainable. It relates to **EU ESG disclosure regulation** as it obliges financial market participants and large public interest entities to make statements about how their financial products and activities align with the taxonomy it specifies.

EU taxonomy and disclosure regulation indirectly affects the standards of conducting business by establishing that an activity will only be considered environmentally sustainable ("green") if it is carried out in compliance with (a) the OECD Guidelines for Multinational Enterprises; (b) the UN Guiding Principles on Business and Human Rights; (c) the International Labour Organization's Declaration on Fundamental Principles and Rights at Work; and (d) the International Bill of Human Rights (the so-called "Minimum Safeguards"). Recital 35 of the EU Taxonomy Regulation clarifies that these Minimum Safeguards should be applied in addition to more stringent requirements on environment, health and safety, and social sustainability set out in EU law.

In practice, companies financed by corporations subject to EU taxonomy and disclosure regulations must put due diligence procedures in place to guarantee that their activities comply with the Minimum Safeguards so they can be considered environmentally sustainable.

3. What measures and best practices can be adopted to implement corporate due diligence duties?

Reporting means that there are actions and a management process on which to inform. Non-financial reporting should not be an *ad hoc* exercise to fulfill the obligation to inform, but rather a consequence of the exercise of applying due diligence procedures and a valid, effective and efficient standard of conduct to manage the impacts of corporate economic activity on the environment and on human rights.

For this purpose, the advisable approach is to apply the international standards incorporated into Spanish legislation itself: the UN Guiding Principles or the OECD Guidelines or both. In practice this will involve executing:

- An analysis of the risks of the activity of companies in relation to the environment and human rights, and prioritization according to their seriousness and probability, both in the operational area of (a) the company and its subsidiaries and, at least, of (b) its suppliers and direct trading partners.

- The adoption and execution of the appropriate actions to prevent and mitigate the risks identified. The prior consultation of interest groups affected by these risks is advisable.

- The establishment of channels for reporting and remedying potential violations.

- A system of accountability and information for all interest groups regarding the due diligence processes and mechanisms implemented and for surveillance and monitoring of their fulfillment and periodic review.

Many companies probably assess the usefulness of delegating these functions to a board committee (either a specific committee or one of the existing committees such as the audit committee) or of employing one or more experts in this respect who report to the management body (e.g., a Chief Sustainability Officer or a Chief Diversity Officer).

The inclusion in the due diligence system of a review of the contractual terms of the company's supply chain is also considered a good practice. This will facilitate the ability to agree on certain shared standards of diligence and a framework of collaboration and vigilance for their fulfillment for the purpose of ensuring valid standards of environment management, health, employment and respect for human rights.

The increased focus on ESG issues by stakeholders has contributed to a rise in shareholder activism (particularly concerning climate-related issues). Fostering a strong engagement policy with shareholders and stakeholders (e.g., employees, suppliers, customers and creditors) helps mitigate this risk as it allows the board to develop a balanced understanding of their views. Afterwards, the board must provide feedback to shareholders and stakeholders and report on how it has considered their views when making decisions.

All these measures are advisable, even necessary, for companies that do not reach the thresholds of the reporting obligation for three reasons:

(i) **ESG factors increasingly drive financing strategies**. Banks, investors and funds no longer make their investment/lending decisions based exclusively on financial parameters. They also consider environmental, social and governance issues, which means companies must be ready to provide clear and complete information on these matters.

Existing EU taxonomy regulations, directly applicable in Spain since January 1, 2022, establish the criteria to determine whether an economic activity is "environmentally sustainable." To be considered "green," an economic activity must meet the social requirements considered Minimal Safeguards (see previous description in section 2 above).

(ii) **The "contagious effect" of other neighboring jurisdictions**. Commercial relations on the European market where our German, French and Norwegian neighbors already have specific domestic rules for supply chain management have a contagious effect on companies that operate outside these countries. Thus, for example, the German Act applies directly to Spanish corporate groups that have a

subsidiary on the German market or that are a subsidiary of a German group that meets the thresholds of number of employees previously mentioned. However, it also has important effects on any Spanish company that is a supplier of a German company bound by that legislation: they will be scrutinized as a direct, or even indirect, supplier. In practice, this means that the Spanish company must conduct an analysis of its own standard of conduct in relation to human rights and environmental management so as to be able to confront the contractual changes that may be required of it by its German customer for the purpose of securely maintaining their commercial relations.

(iii) **Progress of EU and domestic legislation**. In March 2021, the European Parliament approved, on its own initiative, a Proposal for a Corporate Due Diligence and Accountability Directive to establish a European legislative standard of corporate due diligence (a) to ensure that companies fulfil their duty to respect human rights and the environment, (b) to permit the accountability of companies for damage resulting from violations and abuses, and (c) for its extension to the global market through supply chains and corporate organization structures. The European Commission is responsible for converting the Proposal into legislation. For this purpose, it is working on a text which, in principle, it will submit to the Parliament in March 2022.

In Spain, the Annual Legislative Plan for 2022 includes the Government's intention to promote a legislative initiative regarding due diligence and corporate accountability for the impacts on human rights and the environment in line with the legislative trend in our neighboring countries which have already passed specific legislation introducing a binding standard of conduct (France, Germany, Norway) or have planned legislative initiatives in this respect (the Netherlands, Austria and Belgium).

4. What are the enforcement measures and consequences in case of violation?

Enforcement measures must be analyzed on a case-by-case basis. In addition to the specific liability for the breach of sectoral rules (e.g., in the area of the environment or of the regulation of prospectuses in securities market legislation) contractual and civil law actions against companies or its directors (as applicable) potentially come from:

- customers claiming a material defect, challenging sales contracts due to fraudulent misrepresentation or asserting claims arising from pre-contractual liability;
- investors claiming misrepresentations;
- claims relating to suppliers (e.g., recourse claims for reputational damage on a contractual basis or contractual termination rights in the event of violations);
- competitors suing for injunctive relief, removal and damages due to inaccurate reporting; and

- claims by third parties, especially from general tort liability if corresponding duties of care have been violated.

Failure to comply with the reporting obligation set out in Act 11/2018 is also penalized by fines of Euro 1,200 to Euro 60,000 and Euro 300,000 for companies whose annual turnover exceeds Euro 6,000,000. Non-financial reporting should be linked to accountability and, in turn, to the general civil rule of tort under the principle of duty of care and not to harm contained in article 1902 of Spanish Civil Code.

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