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INFORMATION NOTE ON THE DRAFT DIRECTIVE OF THE EUROPEAN PARLIAMENT AND THE COUNCIL ON CORPORATE SUSTAINABILITY DUE DILIGENCE

I. Introduction

On February 23, 2022, the European Commission published the Corporate Sustainability Due Diligence Directive ("**Draft Directive**"), after a series of delays.

In the next step, the Draft Directive will go to the European Parliament and the Council for approval. Once adopted, member states will have two years to transpose and enact the directive.

In general, the purpose of the Draft Directive is to set specific minimum requirements for companies to identify, disclose, monitor and correct the adverse effects of their activities on the environment and human rights and the Draft Directive sets out a European Union ("**EU**") standard on human rights and environmental due diligence. If the Draft Directive is adopted, large companies operating in the EU and outside the EU, their subsidiaries and companies with which they have a relation in the supply chain exceeding a turnover threshold in the EU, are required to undertake an institutional due diligence study that includes determining, prevention and mitigation of human rights and environmental impacts. In addition, the Draft Directive imposes the task of supervising the establishment and implementation of the due diligence process and integrating due diligence into the corporate strategy.

II. General Framework

a. Companies Covered by the Draft Directive

As noted above, the Draft Directive not only covers large EU companies, but also affects non-EU companies. Non-EU companies that meet the EU turnover criteria set out below are covered even if they do not have a physical presence in the EU. Therefore, the Draft Directive could have significant implications for multinational groups based in the US, UK and Asia that meet this turnover test.

➤ **EU companies:**

Group 1	All EU companies with more than 500 employees and a worldwide net turnover of more than 150 million euros
Group 2	EU companies with 250+ employees and worldwide net turnover of €40+ million and operating in defined high-impact sectors(*)

(*) "High impact sectors" include textiles, foodstuffs, agriculture, fisheries, forestry, mineral resource extraction, manufacture of basic metal products and other non-metallic mineral products, and wholesale of mineral resources and basic and intermediate mineral products.

➤ **Non-EU companies:** Non-EU companies operating in the EU exceeding the turnover thresholds for Groups 1 or 2.

Micro companies and SMEs are not covered by the Draft Directive. However, the Draft Directive provides supportive measures for SMEs that may affect them indirectly.

Companies under the Draft Directive do not have to guarantee the prevention or suspension of adverse effects in all circumstances. Instead, an "obligation of means" applies in principle, requiring

companies to take appropriate action that is reasonably expected to prevent or minimize adverse effects of operations. If these measures are not taken, the company will be held responsible for the resulting damages. The Draft Directive also sets forth a special duty of care for the managers in this context.

b. Obligations Imposed on Companies Under the Draft Directive

As stated above, the Draft Directive imposes a **corporate due diligence obligation** on companies. The key elements of this task are the identification, termination, prevention, reduction and accountability of adverse human rights and environmental impacts in the company's own operations, the operations of its subsidiaries, and the operations of companies in its supply chains. Under the Draft Directive, companies are obliged to identify and, where necessary, prevent, end and mitigate the negative impacts of their activities on human rights, such as child labor and the exploitation of workers, and on the environment, such as pollution and loss of biodiversity. Some large companies also need to have a plan in place to ensure their business strategy is aligned with limiting global warming to 1.5°C under the Paris Agreement. Managers are encouraged to contribute to sustainability and climate change mitigation goals.

The Draft Directive also introduces duties for the managers of the covered EU companies. These duties include overseeing the establishment and implementation of due diligence processes and integrating due diligence into corporate strategy. In addition, managers must consider the consequences of their decisions on human rights, climate change and the environment, while performing their duties to act in the best interests of the company.

The Draft Directive also obliges companies to develop a complaint procedure. Accordingly, the complaint procedure should be open to affected persons, trade unions and representatives of workers working in the supply chain and non-governmental organizations.

c. Enforcement and Sanctions

National authorities will have the power to investigate companies for non-compliance with the Directive, either on their own initiative or based on substantiated concerns raised by stakeholders. The competent national authorities of the Member States will also have the power to impose fines based on the turnover of companies. In doing so, they will need to consider the company's efforts to comply with any corrective action and any investment, support and cooperation made by the company to address the associated adverse effects. Enforcement decisions and sanctions in this context will be announced to the public. They will also prevent companies from receiving government aid and/or public support.

Rules for corporate sustainability due diligence will be implemented through:

Administrative supervision: Member States shall designate an authority to supervise and enforce effective, proportionate and dissuasive sanctions, including fines and compliance orders. At European level, the Commission will set up a European Network of Supervisory Authorities that will bring together representatives of national bodies to ensure a coordinated approach.

Legal liability: Member States will ensure that victims receive compensation for damage caused by companies as a result of non-compliance with their obligations.

III. Conclusion

It is widely recognized that the Draft Directive is one of the most ambitious company law reforms ever proposed anywhere in the world. If the Draft Directive is adopted, the implications for both EU and non-EU companies will be far-reaching. It can affect many aspects of day-to-day business, from supply chain management to executive roles, internal corporate governance, risk management and transparency. Preparation for compliance with the Directive and identifying potential material risks along the supply chain will need to start long before the Directive enters into force. Internal policies, codes of conduct, compliance mechanisms, and environmental, social and

governance reporting lines will need to be tested and adjusted to company activity and company partners.

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Should you have any queries on the above, please do not hesitate to contact us.

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