EUROPEAN
COMMISSION

Brussels, 23.2.2022
SWD(2022) 38 final

COMMISSION STAFF WORKING DOCUMENT

Subsidiarity Grid

Accompanying the document

Proposal for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937

{COM(2022) 71 final} - {SEC(2022) 95 final} - {SWD(2022) 39 final} -
{SWD(2022) 42 final} - {SWD(2022) 43 final}

Subsidiarity Grid

1. Can the Union act? What is the legal basis and competence of the Unions' intended action?
1.1 Which article(s) of the Treaty are used to support the legislative proposal or policy initiative?
The legal basis of the proposed initiative is Article 50 TFEU and Article 114 TFEU. Article 50(1) TFEU and in particular Article 50(2)(g) TFEU provide for the EU competence to act in order to attain freedom of establishment as regards a particular activity, in particular "*by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or forms within the meaning of the second paragraph of Article 54 TFEU with a view to making such safeguards equivalent throughout the Union.*" This includes in particular coordination measures concerning the protection of interests of companies' shareholders and other stakeholders with a view to making such protection equivalent throughout the Union, where disparities between national rules are such as to obstruct freedom of establishment. Article 114 TFEU provides for the EU competence to *"adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market"*. The EU legislator may have recourse to Article 114 TFEU in particular where disparities between national rules are such as to obstruct the fundamental freedoms or create distortions of competition and thus have a direct effect on the functioning of the internal market.
1.2 Is the Union competence represented by this Treaty article exclusive, shared or supporting in nature?
In the case of the internal market, including the freedom of establishment, the Union's competence is shared.
*Subsidiarity does not apply for policy areas where the Union has **exclusive** competence as defined in Article 3 TFEU[1]. It is the specific legal basis which determines whether the proposal falls under the subsidiarity control mechanism. Article 4 TFEU[2] sets out the areas where competence is shared between the Union and the Member States. Article 6 TFEU[3] sets out the areas for which the Unions has competence only to support the actions of the Member States.*
2. Subsidiarity Principle: Why should the EU act?
2.1 Does the proposal fulfil the procedural requirements of Protocol No. 2[4]: - Has there been a wide consultation before proposing the act? - Is there a detailed statement with qualitative and, where possible, quantitative indicators allowing an appraisal of whether the action can best be achieved at Union level?
Before proposing this directive, the Commission consulted widely. Those consultation activities

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12008E003&from=EN
[2] https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12008E004&from=EN
[3] https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12008E006:EN:HTML
[4] https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12016E/PRO/02&from=EN

include, in line with the Commission's Better Regulation rules:

- The inception impact assessment (roadmap), which received 114 feedbacks;
- The open public consultation (OPC), which received 473 461 responses from the public, the vast majority of which were submitted through campaigns using pre-filled questionnaires, and 149 of which were position papers;
- A dedicated consultation of social partners;
- A number of stakeholder workshops and meetings, e.g. meeting of the Informal Company Law Expert Group, mainly composed of company law legal academics (ICLEG), meeting with Member State representatives in the Company Law Expert Group (CLEG); and
- Conferences and meetings with business associations, individual businesses, including SMEs representatives, civil society, including non-governmental and not-for-profit organisations, as well as international organisations, such as OECD.

In terms of policy measures, the OPC showed strong support for a mandatory horizontal approach to due diligence over a sector-specific or thematic approach, although there is variation as regards the preferred details of such approach.

Detailed information on the consultation strategy and conclusions of the stakeholder consultations can be found in Chapter 3 of the Explanatory Memorandum to the proposal and in Annex 2 of the impact assessment report.

The Explanatory Memorandum (Chapter 2) and the Impact Assessment (Chapter 3) contain a section on the principle of subsidiarity (see question 2.2. below).

2.2 Does the explanatory memorandum (and any impact assessment) accompanying the Commission's proposal contain an adequate justification regarding the conformity with the principle of subsidiarity?

The text below summarises the arguments presented in Chapter 2 of the Explanatory Memorandum.

The objective of fostering companies' sustainability transition with regard to human rights and environmental risks and impacts, by improving relevant corporate governance practices, avoiding fragmentation of relevant requirements in the single market and creating legal certainty for businesses and stakeholders, can be better achieved at Union level than through Member States individual action**,** for the following reasons:

- Member States' legislation alone in the area is unlikely to be sufficient and efficient. On issues as transnational supply and value chains, success of individual action is hampered by inaction of other Member States.
- Many companies are operating EU-wide or globally; value chains expand to other EU Member States and increasingly to third countries. Many companies have cross-border ownership and their operations are influenced by regulations in some countries or lack of action in others. Frontrunner companies therefore arguably cannot go as far as they would want to in addressing sustainability issues including those in the value chains today and ask for a cross-border level playing field.
- Companies operating across the single market and beyond need legal certainty and a level-playing field for their sustainable growth. Some Member States have recently introduced legislation on due diligence while others are in the process of legislating or considering action. Existing Member State rules and those under preparation do have or would most likely lead to diverging requirements, which risk being ineffective and leading to an uneven playing field. If due diligence requirements are significantly different among Member States, this creates legal uncertainty, fragmentation of the Single market, additional costs and

complexity for companies and their investors operating across borders as well as other stakeholders
- Compared to individual action by Member States, EU intervention can ensure a strong European voice in policy developments at the global level.

2.3 Based on the answers to the questions below, can the objectives of the proposed action be achieved sufficiently by the Member States acting alone (necessity for EU action)?

(a) Are there significant/appreciable transnational/cross-border aspects to the problems being tackled? Have these been quantified?

Sustainability issues are of a European and global dimension and have cross-border effects (e.g. transnational supply and value chains, climate change).

(b) Would national action or the absence of the EU level action conflict with core objectives of the Treaty[5] or significantly damage the interests of other Member States?

National action and the absence of EU level action would conflict with the Treaty objective of establishing the internal market as differing legal frameworks in Member States in the area of this proposal lead to legal uncertainty, fragmentation of the Single market, distortion of competition, additional costs and complexity for companies and their investors operating across borders as well as other stakeholders.

(c) To what extent do Member States have the ability or possibility to enact appropriate measures?

Member States' legislation alone in the area of sustainable corporate governance is unlikely to be sufficient and efficient as sustainability problems are of a European and global dimension and have cross-border effects. Unsustainable behaviour of companies in one Member State or in third countries affects other Member States. Many companies are operating EU-wide or even globally; value chains expand to other EU Member States and increasingly globally. Many companies have cross-border ownership and their operations are influenced by regulations in some countries or lack of action in others. This is one of the reasons why frontrunner companies arguably cannot go as far as they would want to in addressing sustainability issues today and ask for a cross-border level playing field.

(d) How does the problem and its causes (e.g. negative externalities, spill-over effects) vary across the national, regional and local levels of the EU?

The problem and its causes are present across national, regional and local levels throughout the EU.

(e) Is the problem widespread across the EU or limited to a few Member States?

The need to foster the sustainability transition as regards corporate behaviour and avoid regulatory fragmentation in this context is widespread across the EU.

(f) Are Member States overstretched in achieving the objectives of the planned measure?

Measures at Member State level alone would not be able to achieve the objectives of the proposed

[5] https://europa.eu/european-union/about-eu/eu-in-brief_en

initiative. A harmonised approach at EU level avoids diverging requirements at national level, which risk being ineffective and leading to an uneven level playing field; this also creates legal uncertainty, fragmentation of the Single market, additional costs and complexity for companies and their investors operating across borders as well as other stakeholders.

(g) How do the views/preferred courses of action of national, regional and local authorities differ across the EU?

Corporate due diligence is enshrined in existing international frameworks (United Nations Guiding Principles on Business and Human Rights, OECD Responsible Business Conduct Standards), it is therefore internationally recognized as the appropriate tool to mitigate adverse human rights and environmental impacts, including in value chains. As regards mandatory rules, some Member States have recently introduced legislation on sustainable corporate governance or due diligence, while others are in the process of legislating or considering action. Some Member States can be expected not to legislative in this field.

2.4 Based on the answer to the questions below, can the objectives of the proposed action be better achieved at Union level by reason of scale or effects of that action (EU added value)?

(a) Are there clear benefits from EU level action?

Yes. The absence of applicable rules as regards sustainability due diligence at the European level puts frontrunner companies at a competitive disadvantage and rewards unsustainable behaviour. This situation hampers the necessary transition towards a sustainability economy and society. If due diligence requirements are significantly different among Member States, this creates legal uncertainty, fragmentation of the Single market, additional costs and complexity for companies and their investors operating across borders as well as other stakeholders. EU action can avoid this and therefore has added value.

(b) Are there economies of scale? Can the objectives be met more efficiently at EU level (larger benefits per unit cost)? Will the functioning of the internal market be improved?

Yes. As the addressed sustainability issues are of a European and global dimension and have cross-border effects, EU level measures will be more efficient. The functioning of the internal market will be improved by avoiding fragmentation through differing emerging national frameworks.

(c) What are the benefits in replacing different national policies and rules with a more homogenous policy approach?

Businesses need legal certainty, and a harmonised approach in the Internal market. EU level rules are expected to be more efficient and allow to better exploit the potential of the single market to contribute to the transition to a sustainable economy.

(d) Do the benefits of EU-level action outweigh the loss of competence of the Member States and the local and regional authorities (beyond the costs and benefits of acting at national, regional and local levels)?

While competence is shared between the EU and the Member States in the area of the internal market, including freedom of establishment, EU-wide measures are necessary to effectively foster the sustainability transition, while avoiding fragmentation of the internal market. As the chosen instrument is a directive, Member States will be able – by transposing the EU rules into their national

laws – to take account of the need for consistency and coherence within the national/regional legal systems.

(e) Will there be improved legal clarity for those having to implement the legislation?

It is expected that EU harmonised rules in the area of sustainability due diligence lead to improved legal certainty as compared to today's fragmented legal framework.

3. Proportionality: How the EU should act

3.1 Does the explanatory memorandum (and any impact assessment) accompanying the Commission's proposal contain an adequate justification regarding the proportionality of the proposal and a statement allowing appraisal of the compliance of the proposal with the principle of proportionality?

The explanatory memorandum (Chapter 2) contains a section on the principle of proportionality, as summarised below.

The proposed measures do not go beyond what is necessary to achieve the objectives of the initiative. In particular, burden on companies stemming from compliance costs has been adapted to the size and resources available to the company, and the risk profile.

- As regards the **personal scope** of the due diligence obligations, proportionality is ensured as follows:
  - small and medium sized enterprises as well as micro companies are excluded from the due diligence duty. They will still be exposed to some of the costs and burden through business relationships with companies in scope, hence supporting measures will be necessary to help them build operational and financial capacity.
  - very large companies (with more than 500 employees and more than 150 Mio turnover) will be within the scope of the full due diligence obligation. In particular the selected turnover criteria will filter those having the largest impact on the EU economy.
  - regarding companies with lower turnover and less employees , the due diligence obligation is limited to larger midcap companies (with more than 250 employees and more than EUR 40 million net turnover but not exceeding the 500 employee and EUR 150 million net turnover thresholds simultaneously) which are active in particularly high-impact sectors covered by existing sectoral OECD guidance. For them, the due diligence obligation will be simplified as they would only focus on severe adverse impacts and perform the scoping of the risks that is commensurate to the complexity of the value chain, sector, product or geography. The due diligence obligation will apply to them only 3 years later than to other companies.
- As regards **enforcement**, the Directive will provide for a combination of administrative sanctions and civil liability.
  - As regards private enforcement through civil liability going beyond harm done at the level of the direct supplier, the approach concerns only established business relationships with which a company has regular and frequent cooperation and applies only where the adverse impact could have been foreseen, prevented, ceased or mitigated with appropriate due diligence measures. As it will in practice be difficult to prevent all risks through global value chains, liability is limited to harm done in the value chain under specific conditions especially beyond direct suppliers.
  - The measures related to public enforcement of the due diligence duty do not go beyond what is necessary. The power of public authorities to supervise and impose

proportionate pecuniary sanctions in case of non-compliance as provided for in the proposal is key to the effective enforcement regime.
3.2 Based on the answers to the questions below and information available from any impact assessment, the explanatory memorandum or other sources, is the proposed action an appropriate way to achieve the intended objectives?
(a) Is the initiative limited to those aspects that Member States cannot achieve satisfactorily on their own, and where the Union can do better?
Yes, as detailed above in the replies to the sub-questions of question 2.3.
(b) Is the form of Union action (choice of instrument) justified, as simple as possible, and coherent with the satisfactory achievement of, and ensuring compliance with the objectives pursued (e.g. choice between regulation, (framework) directive, recommendation, or alternative regulatory methods such as co-legislation, etc.)?
The proposed instrument is a Directive, since Article 50 TFEU requires the European Parliament and the Council to act by means of directives. Consequently, Member States will be able – by transposing the EU rules into their national laws – to take account of the need for consistency and coherence within the national legal systems. In order to supplement the content of the reporting obligations under the Directive for companies not falling under Directive 2013/34/EU, delegated acts will be adopted. In order to provide support to companies or to Member State authorities on how companies should fulfil their due diligence obligations, the Commission may issue guidelineson different aspects of the proposed directive.
(c) Does the Union action leave as much scope for national decision as possible while achieving satisfactorily the objectives set? (e.g. is it possible to limit the European action to minimum standards or use a less stringent policy instrument or approach?)
It is not possible to limit the European action further, e.g. to voluntary measures. Using the existing international voluntary standards on responsible business conduct (UNGP, OEDC guidance), an increasing number of EU companies are using due diligence as a tool to identify risks in their value chains and build resilience, but companies also may face difficulties when considering the due diligence for their activities. Also voluntary standards do not result in legal certainty for neither companies nor victims in case harm occurs. Finally, voluntary action does not appear to have resulted in large scale improvement across sectors and, as a consequence, negative externalities from EU production and consumption are being observed both inside and outside EU.
(d) Does the initiative create financial or administrative cost for the Union, national governments, regional or local authorities, economic operators or citizens? Are these costs commensurate with the objective to be achieved?
The proposed directive does not entail unnecessary costs for the Union, national governments, regional or local authorities. It will leave it up to the Member States how to organise enforcement. Administrative supervision can be carried out by existing authorities. To reduce the costs and improve the supervision, coordination, investigation and exchange of information the Commission will set up a European Network of Supervisory Authorities. Supervisory costs incurred under the proposed directive by existing or newly set up public authorities that will be designated by Member

States to monitor and enforce compliance have been estimated in detail in the Staff Working Document (SWD) accompanying the legislative proposal ("Follow-up to then second opinion of the Regulatory Scrutiny Board")(Section 4.1.), adapted from the initial calculations in the Impact Assessment (Annex 4).
Aggregated direct compliance costs for EU businesses under the proposed directive have been estimated in the SWD (Section 4.1.), adapted from the initial calculations in the Impact Assessment (Annex 4).
The expected estimated costs are commensurate with the objective to be achieved, as a more limited EU action is not expected to achieve the objectives and yield the expected results.

(e) While respecting the Union law, have special circumstances applying in individual Member States been taken into account?

Existing Member States' laws in the area of corporate sustainability due diligence, as well as findings on experience with them (e.g. on the French legislation on the "Devoir de vigilance") have been thoroughly examined in the preparation of this proposal, as well as the current practices in Member States building on the existing voluntary framework.