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Corporate Environmental Responsibility in Global Value Chains:

An assessment of how the proposed EU Directive on Corporate Sustainability Due Diligence can affect the environmental responsibility of multinational companies

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Abstract

Multinational enterprises are governed by international frameworks such as the United Nations Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises. The failure of multinational enterprises to comply with these voluntary guidelines has led to negative environmental impacts. Against this background, the European Commission has proposed an EU Directive on Corporate Sustainability Due Diligence that aims to harmonise due diligence legislation across the Union. This thesis examines the environmental responsibilities of multinational companies in their value chains. It also considers the implications of the proposed EU Directive on Corporate Sustainability Due Diligence for Swedish legislation.

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Abbreviations

CER	Corporate Environmental Responsibility
CR	Corporate Responsibility
CSR	Corporate Social Responsibility
FRA	Fundamental Rights Agency
GVC	Global Value Chain
MNE	Multinational Enterprise
NCP	National Contact Point
OECD	Organisation for Economic Co-operation and Development
SME	Small and Medium-size Enterprise
UNCTAD	United Nations Conference on Trade and Development

1 Introduction

1.1 Background

In 2015, a mudslide in Mariana, Brazil, killed 19 people and displaced hundreds. The mudslide was triggered by the collapse of a tailing dam owned by the multinational corporations Vale and BHP Billiton.[1] The mine waste was washed through the surrounding environment and through villages. 826 kilometres of the Doce river basin were covered by mud, polluting the water.[2] As a result, 250,000 people were deprived of their drinking water.[3]

Vale is a global mining company that operates in 30 countries. According to Vale's company policy, "life matters most" to them, including safe and reliable mining.[4] In addition, Vale emphasises the importance of sustainable development in its operations, both globally and locally.[5] In 2019, however, disaster struck again in Brumadinho, located in the same state as Mariana. At least 58 people were killed by the mudslide and hundreds went missing. The same company, Vale, was responsible for the mining operations.[6] It is clear that Vale did not meet its own commitments on safe mining or protection of life.

The two disasters highlight the need for a legal framework that forces companies like Vale to adequately assess the risks of their activities and to be held accountable for negative impacts on the environmental and human rights.

In multinational enterprises (MNE), there is often a parent company that has financial control over all subsidiaries. A multinational enterprise is thus a single economic entity. However, the legal definition of MNEs differs from the economic one. The parent company is governed by the national laws of the state in which it is registered. But the subsidiaries of such a company are not governed by the same laws if they are located in another country. Each subsidiary

[1] Business & Human Rights Resource Centre "Brazil dam victims: 'The tragedy does not end when the mud stops running'" (28 January 2019).

[2] ibid.

[3] Business & Human Rights Resource Centre "Brazil activists in London seeking justice over Doce River disaster" (7 November 2018).

[4] Vale "About Vale, Our Commitments".

[5] ibid.

[6] Business & Human Rights Resource Centre "Brumadinho dam collapse: lessons in corporate due diligence and remedy for harm done" (28 January 2019).

therefore complies with the laws of the country in which it operates. As a result, the parent company may not be liable for environmental violations caused by the subsidiary's activities. In addition, the subsidiary may have its own subsidiaries that make further use of limited liability. Nevertheless, the company is entitled to the revenue from the subsidiary.[7]

Multinational enterprises have acquired great power through their economic value.[8] In 2018, multinationals accounted for more than 50% of global exports and 28% of world GDP.[9] The Organisation for Economic Co-operation and Development (OECD) report describes multinationals as the largest players in the global economy and as drivers of further fragmentation of global supply chains.[10] It has been argued that "MNEs increasingly 'rule' the global economy" and that they force governments to obey the lobbying of multinational enterprises.[11]

It is important to demand that multinational companies take environmental responsibility. There is growing movement around the world to introduce binding obligations on companies. In addition to national legislation regulating MNEs, there are voluntary initiatives aimed at encouraging companies to act with due diligence, such as the United Nations Guiding Principles on Business and Human Rights[12] and the OECD Guidelines for Multinational Enterprises.[13] However, such non-binding regulatory initiatives have proven to be insufficient to implement due diligence measures.[14] At the same time, recent developments in due diligence legislation have shown that

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[7] Ruggie 2017, p. 320.

[8] In addition, the 2002 report from the United Nations Conference on Trade and Development (UNCTAD) makes a comparison between the added value of MNEs and the added value of certain countries. The report showed that the Exxon group had roughly the same added value as the economy of Chile. Similarly, Chrysler could be measured by the added value of Nigeria and Phillips by that of Slovakia. See UNCTAD "Are Transnationals Bigger than Countries?" TAD/INF/ PR/47 (12 August 2002).

[9] OECD "Multinational enterprises in the global economy Heavily debated but hardly measured" (May 2018).

[10] ibid.

[11] ibid.

[12] United Nations Human Rights Office of the High Commissioner HR/PUB/11/04 (2011), *Guiding Principles on Business and Human Rights. Implementing the United Nations "Protect, Respect and Remedy" Framework.* New York and Geneva.

[13] OECD (2011), *OECD Guidelines for Multinational Enterprises, 2011 Edition*, OECD Publishing, Paris, https://doi.org/10.1787/9789264115415-en.

[14] Business & Human Rights Resource Centre "Towards EU Mandatory Due Diligence Legislation Perspectives from Business, Public Sector, Academia and Civil Society" (November 2020), p. 5-6.

parent companies can be held liable for the activities of their subsidiaries.[15] This thesis will therefore focus on examining the potential impact of the proposed EU Directive on Corporate Sustainability Due Diligence.[16]

1.2 Purpose and Research Questions

Corporate environmental responsibility is insufficient, especially in global value chains. One way to fill this gap in legislation may be to introduce corporate due diligence. The aim of this thesis is therefore to answer the following research questions:

What obligations do multinational enterprises have with regard to environmental due diligence in their global value chains?

What implications could the proposed EU Directive on Corporate Sustainability Due Diligence have for Swedish legislation?

1.3 Methodology

The legal dogmatic method with elements of conceptual, analytical and qualitative research is used to answer the research questions in this thesis. Given that the research questions themselves determine the methodology and that the methodology is the way to solve a certain question, the chosen method is well suited to the research questions, since the researcher aims to present, apply and analyse legal sources primarily from a positivist point of view.[17]

The aim of this thesis is to establish *de lege lata* by examining the legislation regulating corporate environmental due diligence. The established legislation will then be analysed by applying a *critical de lege lata* perspective. Lastly, a *lege ferenda* perspective will be provided by presenting the potential impact of the proposed EU Directive Corporate Sustainability Due Diligence on Swedish legislation.

This thesis also relies on the comparative legal analysis. The comparative method makes it possible to compare common features and differences between the research objectives, which

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[15] Se for example, Loi No 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre.

[16] COM(2022) 71 final. Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937.

[17] Smits 2017, p. 5.

enables a conclusion to be reached that would not be possible with only one research object.[18] The comparative approach will be applied in the assessment of national due diligence practices.

The sources used to answer the research questions are primary and secondary EU legislation and Swedish national legislation. In addition, soft law instruments such as the OECD Guidelines and the United Nations Principles on Business and Human Rights are applied. Soft law instruments are not binding per se, but can be useful in unexplored areas of law to identify gaps in legislation and provide a basis for future legislative proposals. Yet, it is important to note that soft law documents may have varying degrees of authority. For example, it could be argued that the endorsement of the Human Rights Council gives greater authority to the United Nations Guiding Principles on Business and Human Rights.[19]

1.4 Limitations

There are other internationally recognised instruments that would have been relevant to this thesis. One example is the United Nations Global Compact, which sets out principles for companies to apply in environmental matters. However, these have been omitted due to space limitations. The French and German due diligence laws were selected because of their environmental focus and were therefore suitable for inclusion in this thesis. There are initiatives in other countries that may be relevant to this thesis, such as the Netherlands and Norway. However, they have been excluded because of the space limit.

1.5 Structure

Following the introduction, Chapter 2 describes the international due diligence framework and national due diligence practice. Chapter 3 aims to clarify the due diligence obligations in EU law and provides an analysis of the proposed EU Directive on Corporate Sustainability Due Diligence**.** Chapter 4 presents the relevant Swedish legislation and continues with an assessment of the potential impact of the proposed EU Directive on Swedish legislation. Chapter 5 concludes.

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[18] Bhat 2015.

[19] UNGA Res. A/HRC/RES/17/4, 16 June 2011.

2 International Legal Framework of Corporate Environmental Responsibility

Multilateral enterprises play an important role in today's global economy.[20] Multinationals drive economic development, both globally and locally. At the same time, the environmental impact of MNEs is increasing. With economic prosperity and development comes, among other things, environmental degradation, ecosystem loss and climate warming.[21] The activities of MNEs thus have a major impact on the environment and sustainable development.[22] Therefore, there is a need for legally binding obligations on corporate responsibility in order to limit the negative environmental effects of MNEs. The purpose of the following sections is to describe and analyse the environmental responsibilities of MNEs in the context of international law.

2.1 Multinational enterprises, the concept of corporate environmental responsibility and value chains

There is no generally accepted legal definition of MNEs.[23] The OECD argues that a definition of MNEs is redundant.[24] Arguably this claim is supported by the nature of MNEs, as they operate in different countries, sectors and markets. A too narrow definition could lead to the exclusion of enterprises from the definition and thus from responsibility. Nevertheless, the OECD provides a description of multinational enterprises. According to the OECD Guidelines:

> They usually comprise companies or other entities established in more than one country and so linked that they may coordinate their operations in various ways. While one or more of these entities may be able to exercise a significant influence over the activities of others, their degree of autonomy within the enterprise may vary widely from one multinational enterprise to another. Ownership may be private, State or mixed.[25]

[20] OECD "Multinational enterprises in the global economy Heavily debated but hardly measured" (May 2018).

[21] Nollkaemper 2006, p. 180.

[22] ibid.

[23] Morgera 2020, p. 63.

[24] OECD Guidelines for Multinational Enterprises (2011), Part I, Ch. 1, para 4.

[25] ibid.

This description of MNEs is consistent with the researchers' view of how to define MNEs.[26]

Corporate responsibility (CR), as opposed to the profit motive, is about the social and environmental commitments of companies.[27] CR is most widespread in the developed world, but the concept has spread to developing countries as a result of globalisation.[28] The social component of CR, also known as corporate social responsibility (CSR) is a well-known concept in the business world, although there is no unanimous definition.[29] The World Business Council for Sustainable Development has defined CSR as:

> Corporate social responsibility is the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life.[30]

In general terms CSR usually refers to the impact that companies have on society.[31] The concept is complex, and CSR has been defined in different ways by different stakeholders. The elements and design of CSR have been widely discussed by schools, businesses and civil society. [32] A phenomenon that can be quite problematic if companies intend to harmonise their CSR policies with social norms.[33] It has been argued that a precise definition of CSR is superfluous due to the ever-changing nature of the field.[34] However, there are some common features that can be discerned. According to Dahlsrud, the different dimensions of CSR are environment, social, economic, stakeholder and voluntariness.[35]

The environmental dimension, also known as corporate environmental responsibility (CER), has its origins in the concept of corporate responsibility and corporate social responsibility.[36] The most vital part of CER is the interaction between companies activities and the

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[26] Huarte Melgar et al. 2011, p. 22.

[27] W. H. Lo 2008, p. 2.

[28] ibid.

[29] Mahmudar Rahim 2013, p. 13.

[30] World Business Council for Sustainable Development. 2000, p. 10.

[31] Mahmudar Rahim 2013, p. 13.

[32] Dathe et al. 2022, p. 24.

[33] ibid, p. 24-25

[34] Snider et al. 2003, p. 175.

[35] Dahlsrud 2008, p. 4.

[36] Holtbrügge and Dögl 2012, p. 180.

environment.[37] According to Gunningham, CER is defined as "practices that benefit the environment (or mitigate the adverse impact of business on the environment) that go beyond those that companies are legally obliged to carry out."[38] This is generally in line with the World Business Council for Sustainable Development's and the industry's expression of CER.[39] The European Commission includes the environmental aspect in its definition of CSR. Accordingly, the Commission defines CSR as a "concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis."[40] It is clear from the two definitions that CER is voluntary in nature. It has been argued that CER is primarily driven by stakeholders, as they exert pressure on the company on environmental issues[41].

Global value chains (GVC) encompass the steps leading to a finished product. The concept of value chain has been described as "the full range of activities that firms and workers perform to bring a product from its conception to end use and beyond."[42] The steps commonly involved in the value chain are "design, production, marketing, distribution and support to the final consumer".[43] GVCs link different actors and can therefore act as an amplifier of developing countries' participation in the global economy.[44] It has been argued that the inclusion of actors in developing countries in GVCs is crucial for their development, to eradicate poverty and to improve employment rates.[45] At the same time, the benefits of economic prosperity have drawbacks in the form of environmental degradation and human rights abuses.

Traditionally, goods traded between countries have been produced in one country, ready to be exported and used in another country. However, globalisation has changed international trade, with 70% of international trade now taking place through GVCs. Raw materials are now

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[37] ibid.

[38] Gunningham 2009, p. 215.

[39] ibid, p. 215-216.

[40] COM(2006) 0136 final. Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee - Implementing the partnership for growth and jobs: making Europe a pole of excellence on corporate social responsibility.

[41] Kovács 2008, p. 1571.

[42] Gereffi and Fernandez-Stark 2011, p. 4.

[43] ibid.

[44] ibid, p. 2.

[45] ibid.

imported from different countries to be incorporated into products that are then exported globally.[46] Nutella is one good example of this fragmented landscape of global trade. The main components of a jar of Nutella is cocoa, hazelnuts and palm oil which come from Africa, the Middle East and Asia. Several environmental and human rights violations have been reported in connection with the production of Nutella.[47] These include deforestation of the rainforest in Indonesia which is affecting biodiversity, the people who live in or near the rainforest and the climate due to increased greenhouse gas emissions.[48] In addition, when palm oil plantations are built, the orangutans that live in the forest are killed.[49]

In order to reduce the environmental and social impact of MNEs, it is important that the parent company takes responsibility for the operations in its value chain. A growing body of international guidelines and national legislation on corporate due diligence has emerged as a tool to curb such impacts. These will be described in more detail below.

2.2 The concept of due diligence

Due diligence is a widely known concept within law but also in economics. The issue with this is however that due diligence is not defined in the same way in both disciplines.[50] In simple terms, human rights lawyers tend to understand due diligence as a duty to comply with an obligation. Economists, on the other hand, see due diligence as a tool to govern business risk.[51] This thesis focuses on the legal definition of due diligence.

The concept of due diligence within law has its origin in human rights. Ruggie, former Special Representative of the UN Secretary-General on human rights and transnational corporations and other business enterprises provided a framework for addressing the link between business and human rights.[52] The "Protect, Respect and Remedy" framework was implemented in the United Nations Guiding Principles on Business and Human Rights endorsed by the Human

[46] OECD "Global value chains and trade".

[47] The Washington Post "What Nutella Teaches Us About Global Supply Chain Risks" (8 November 2021).

[48] ibid.

[49] GRID Arendal "The Last Stand of the Orangutan: State of Emergency-Illegal Logging, Fire and Palm Oil in Indonesia's National Parks" (17 October 2007).

[50] Bonnitcha and McCorquodale 2017, p. 900.

[51] ibid.

[52] United Nations Human Rights Office of the High Commissioner "Special Representative of the Secretary-General on human rights and transnational corporations and other business enterprises".

Rights Council.[53] The Guiding Principles apply worldwide to states and companies, regardless of size, whether they are multinational companies, country of origin or sector.[54]

The Guiding Principles set out the framework for human rights due diligence in Principle 17. Accordingly, "identify, prevent, mitigate and account for (…) adverse human rights impacts" is key to human rights due diligence,[55] including both "actual and potential human rights impact".[56] Adverse effects caused by the company's own activities, but also by the activities of other entities related the company's activities, shall be covered.[57] The level of due diligence that is obliged to be carried out depends on the "size (…) the risk of severe human rights impacts (…) the nature and context of [the company and its] operations"[58] Finally, the assessment should be continuous, as the risks may change due to structural changes in the company.[59]

Bonnitcha and McCorquodale argue that the duty to act with due diligence differs depending on who is responsible for the adverse human rights impact.[60] Accordingly, Principle 13 of the Guiding Principles states that:

> The responsibility to respect human rights requires that business enterprises:
> (a) Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur;
> (b) Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts.[61]

The Commentary clarifies that "business relationships" refers to all entities in the enterprises value chain, and other actors directly linked to its operations, both private and publicly owned.[62] Principle 13 show the different dimensions of enterprises responsibility. Clearly, enterprises

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[53] United Nations Guiding Principles on Business and Human Rights (2011).

[54] ibid.

[55] ibid, Principle 17.

[56] ibid.

[57] ibid, Principle 17(a).

[58] ibid, Principle 17(b).

[59] ibid Principle 17(c).

[60] Bonnitcha and McCorquodale 2017, p. 912-914.

[61] United Nations Guiding Principles on Business and Human Rights (2011) Principle 13.

[62] ibid, Commentary to Principle 13.

have greater responsibility to avoid adverse effect with regard to their own activities. Yet, they should still strive to prevent or mitigate adverse impact caused by entities in their business relationships.

Further, Principle 17 recognises that companies can avoid human rights abuses by exercising due diligence. The application of due diligence is at the same time not a guarantee of avoiding liability for human rights abuses.[63] Yet, it has been argued that companies' duty to act with due diligence in relation to value chain activities, business relationships and other entities can be fulfilled by taking adequate measures to identify, prevent and mitigate adverse human rights impacts, and thus avoid liability.[64] One of the reasons for this is that companies could otherwise be held responsible for human rights violations committed by distant entities down the value chain or by state-owned enterprises. Given the complexity of value chains, companies may simply not have sufficient leverage to influence certain aspects of their business relationships.[65]

2.3 OECD Guidelines

There have been many initiatives aimed at influencing policies of multinational companies. However, the OECD Guidelines for Multinational Enterprises[66] can be considered the most widely recognised initiative at international level.[67] The Guidelines were last updated in 2011 and have been endorsed by 38-member states.[68]

The Guidelines are primarily aimed at companies. However, member states are also covered by its scope. Accordingly, states are obliged to implement the guidelines according to the *Decision of the OECD Council on the OECD Guidelines for Multinational Enterprises*.[69] Hence, the Guidelines are binding on states but not on companies.[70]

Nevertheless, according to Chapter VI about the environment, "[e]nterprises should, within the framework of laws, (…) international agreements, principles, objectives and standards, take

[63] ibid, Principle 17 and the Commentary.

[64] Bonnitcha and McCorquodale 2017, p. 914-915.

[65] ibid p. 914.

[66] OECD Guidelines for Multinational Enterprises (2011).

[67] Egelund Olsen and Engsig Sorensen 2014, p. 10.

[68] OECD "Our global reach".

[69] OECD Guidelines for Multinational Enterprises (2011) Part I, Preface para 1.

[70] ibid; Huarte Melgar et al. 2011, p. 19.

due account of the need to protect the environment"[71]. Enterprises are not subject to international law, yet the Guidelines claim that they "should" operate within the recognised international legal framework. The guidelines are not intended to override national law; the national law of the host country is the primary applicable law. Accordingly, it is stressed that companies should comply with the Guidelines to the greatest extent possible without contravening national legislation.[72]

In addition, wholly or partly state-owned companies fall within the scope of the guidelines, which is essential in order to comprehensively cover all types of companies.[73] The Guidelines refer to "enterprises operating in or from their territories".[74] which also covers a wide range of enterprises, as determining the nationality of a multinational enterprise can be complicated.[75] In addition, both parent company and its subsidiaries are covered by the Guidelines.[76] Thus, the aim is to encourage all companies, not just those of a particular size or sector, to take account of the Guidelines.[77]

The nature of MNEs has been recognised in the Guidelines. Accordingly, MNEs operate internationally and the Guidelines therefore claims that MNEs should co-operate on a worldwide basis.[78] According to the Guidelines, "[g]overnments adhering to the *Guidelines* encourage the enterprises operating in their territories to observe the Guidelines wherever they operate".[79] This assertion implies that the Guidelines have a rather wide extraterritorial scope, despite the fact that the obligation is only to *encourage* enterprises to cooperate, which in itself is a rather vague obligation. The OECD does not provide clear strategies for enterprises to

[71] ibid, Part I, Ch. VI.

[72] ibid, Part I, Ch. I, para 2.

[73] Huarte Melgar et al. 2011, p. 22.

[74] OECD Guidelines for Multinational Enterprises (2011) Part II Amendment of the Decision of the Council on the OECD Guidelines for Multinational Enterprises.

[75] Huarte Melgar et al. 2011, pp. 22-23.

[76] OECD Guidelines for Multinational Enterprises (2011) Part I, Ch. I para 4.

[77] ibid.

[78] OECD Guidelines for Multinational Enterprises (2011) Part I, Ch. I para 3.

[79] ibid.

implement. However, the OECD has developed more specific guidelines for sectors that are particularly at risk, such as agriculture, textiles, mining and the financial sector.[80]

What can also be noted is that the guidelines focus on the supply chain rather than only regulating the entities operating in the member states.[81] However, it can be argued that the implementation of such requirement may be problematic. Yet, implementation issues in "specific instances" are addressed by the commentary. Accordingly, the National Contact Point (NCP) is the body to assist in such matters.[82].

The OECD Guidelines requires members to set up an NCP. The NCP is the function that is responsible for implementation and compliance of the Guidelines. Yet, member states enjoy a certain level of discretion when establishing their NCP.[83] Because of this discretion, there are wide variations in the way NCPs has been implemented. The Dutch NCP includes an obligation for companies to report their greenhouse gas emissions to the NCP. This obligation also covers the "business relations" of parent companies.[84] Hence, NCPs may have different functions dependant on the country in which they are implemented. Some states have introduced the NCP as a forum for dispute resolution.[85] It has therefore been argued that the OECD Guidelines are not just "soft law" but rather a hybrid between soft law and hard law.[86]

2.4 Due diligence in the OECD Guidelines

The OECD has recognised the growing role of multinational enterprises in the global economy and the importance of adapting the guidelines to this change. With increased power should come increased responsibility for *inter alia* the environment. Thus, Chapter VI of the OECD Guidelines therefore contains recommendations on companies' environmental performance.[87]

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[80] OECD "Guidelines for multinational enterprises" <https://www.oecd.org/corporate/mne/> (accessed 20 May 2022).

[81] Huarte Melgar et al. 2011, p 25.

[82] OECD Guidelines for Multinational Enterprises (2011) Part II, Commentary on the Implementation Procedures of the OECD Guidelines for Multinational Enterprises, para 20.

[83] OECD Guidelines for Multinational Enterprises (2011) Part I, Ch. I, para 11; Egelund Olsen and Engsig Sorensen 2014, p. 10.

[84] Macchi 2022, p. 95.

[85] Egelund Olsen and Engsig Sorensen 2014, p. 10.

[86] ibid.

[87] OECD Guidelines for Multinational Enterprises (2011) Part I, Ch. VI.

The main objective of the Guidelines is sustainable development. To achieve this goal, it is recognised that companies should "take due account" of environmental protection.[88] It could be argued that "due account" is a reference for companies to act with due diligence. In addition, the general policy of the guidelines provides that companies should:

> Carry out risk-based due diligence, for example by incorporating it into their enterprise risk management systems, to identify, prevent and mitigate actual and potential adverse impacts (...). The nature and extent of due diligence depend on the circumstances of a particular situation.[89]

This shows that the level of due diligence a company must demonstrate should be assessed on a case-by-case basis. When defining due diligence steps and measures, certain factors must be taken into account, such as the size and nature of the company's business. In addition, account must be taken of the Guidelines itself, in particular Chapter VI on the risks of environmental damage, and the severity of the adverse effects.[90]

Enterprises can decide for themselves how they want to carry out due diligence, as integrating due diligence into the risk management system is only mentioned as a suggestion. Paragraph 11 and 12 further describes how enterprises should go about to "identify, prevent and mitigate actual and potential adverse impacts"[91]

Companies should refrain from allowing their activities to undermine the objectives of the guidelines. If such damage does occur, the company must address it.[92] Paragraphs 12 further states that enterprises should:

> "Seek to prevent or mitigate an adverse impact where they have not contributed to that impact, when the impact is nevertheless directly linked to their operations, products or services by a business relationship."[93]

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88 ibid.

89 ibid, Part I, Ch. II, para 10.

90 ibid, Part I, Ch. II, Commentary on General Policies, para 15.

91 ibid, Part I, Ch. II, para 10.

92 ibid, Part I, Ch. II, para 11.

93 ibid, Part I, Ch. II, para 12.

This suggests that an enterprise has quite a lot of responsibility for its business relationships. However, the second part of the paragraph denies this extended responsibility by stating that: "[t]his is not intended to shift responsibility from the entity causing an adverse impact to the enterprise with which it has a business relationship."[94] Nevertheless, enterprises are encouraged to prevent and mitigate impact that affects them, even if they are not the ones responsible of the damage. The commentary clarifies the concept of *business relationship* by including "entities directly linked to its business operations, products or services".[95] In addition, it covers all entities in the supply chain including both state and non-state actors.[96]

The Commentary on General Policies propose that enterprises may take due diligence measures that go beyond the concept of "identify, prevent, mitigate".[97] Hence, due diligence can be extended to a broader application in a risk management system. Companies could switch their focus from only being interested in risks that are directly linked to them or that affect them to also including risks of negative impacts that affect issues linked to the guidelines.[98] This reasoning allows for an extension of the environmental due diligence measures set out in the Guidelines and to integrate such risk management of adverse impacts related to the environment that are not explicitly mentioned in the guidelines.

The wording of Chapter VI does not explicitly express due diligence. But it becomes clear in the Commentary that due diligence applies to all areas of the Guidelines which is associated with adverse impacts.[99] The OECD Due Diligence Guidance for Responsible Business Conduct provide a list on examples of adverse environmental impacts that are covered by the Guidelines, as follows:

> Ecosystem degradation through land degradation, water resource depletion, and/or destruction of pristine forests and biodiversity. Unsafe levels of biological, chemical or physical hazards in products or services. Water pollution (e.g.

[94] ibid, Part I, Ch. II, para 12.

[95] ibid, Part I, Ch. II, Commentary on General Policies, para 14.

[96] ibid.

[97] ibid.

[98] ibid.

[99] ibid, the Chapters on Science and Technology, Competition and Taxation are excepted from the application of due diligence.

through discharging waste water without regard to adequate wastewater infrastructure).[100]

However, OECD Watch points out that important concepts such as greenhouse gas emission mitigation or climate change adaptation are lacking in the Guidelines. Nor does it mention the Paris Agreement.[101]

Chapter VI of the Guidelines stresses the importance of environmental management in achieving the overall objective of sustainable development. Accordingly, enterprises shall create a system of environmental management which is motivated by its contribution to both responsibility, opportunity and economic benefits of the enterprise.[102] Such a system should include the gathering and assessment of environmental information on the enterprises' activities.[103] The system itself will enable the enterprise to improve its environmental protection.[104]

According to the commentary, "sound environmental management" must be interpreted extensively to include direct and indirect effects with a long-term perspective. Including an assessment about pollution and resources.[105] Such a long-term perspective can also be applied by adopting long-term greenhouse gas emission targets.[106]

Enterprises should establish environmental objectives. However, environmental targets are only required if they are "appropriate".[107] There is no specific obligations to set climate

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[100] OECD (2018), *OECD Due Diligence Guidance for Responsible Business Conduct,* p. 39.

[101] OECD Watch, "Advocacy brief: Arguments for updating the OECD Guidelines to improve business standards on climate change and the environment" (February 2022). p. 1; The 2018 OECD Due Diligence Guidance for Responsible Business Conduct mention greenhouse gases, but only in the context of stakeholder participation and transboundary harm, see: OECD (2018), *OECD Due Diligence Guidance for Responsible Business Conduct,* p. 50.

[102] OECD Guidelines for Multinational Enterprises (2011) Part I, Ch. VI, Commentary on the Environment, paras 61-62.

[103] ibid, Part I, Ch. VI, para 1(a).

[104] ibid, Part I, Ch. VI, Commentary on the Environment, para 61.

[105] ibid, para 63.

[106] OECD Watch, "Advocacy brief: Arguments for updating the OECD Guidelines to improve business standards on climate change and the environment" (February 2022). p. 2.

[107] OECD Guidelines for Multinational Enterprises (2011) Part I, Ch. VI, para 1(b).

targets.[108] However, if such targets are set, they should be verified, managed and reviewed.[109] It can be argued that information and verifiable targets are crucial for assessing companies' environmental progress. It may therefore be necessary to adopt an internal control system to monitor the status and development of environmental targets.[110]

OECD Watch advocates a value chain perspective rather than a supply chain perspective when assessing climate risks that may affect local communities, as the value chain is a broader concept that encompasses both upstream and downstream activities.[111] In addition, climate risks are linked to the human rights of local communities and including climate risks in the due diligence process can improve the realisation of human rights.[112]

In summary, the Guidelines are rather vague in some areas leaving enterprises a wide discretion. A specific reference to due diligence obligations in the Environmental Chapter would send a clearer signal to enterprises about their environmental due diligence obligations. In some sections of the guidelines, enterprises have the opportunity to improve their environmental standards where they consider it appropriate. Targets and objectives that are evaluated and monitored can help enterprises to improve their environmental standards to meet their due diligence obligations. Targets can also be an effective tool in holding multinational enterprises accountable for failing to act with due diligence. In addition, the inclusion of a climate change perspective with mitigation and adaptation plans is necessary to be in line with the international climate change regime. Enterprises may not be the subjects to such regime but as they are major contributors to global warming it is crucial that they have strategies in place to deal with climate change.

[108] OECD Watch, "Advocacy brief: Arguments for updating the OECD Guidelines to improve business standards on climate change and the environment" (February 2022). p. 1.

[109] OECD Guidelines for Multinational Enterprises (2011) Part I, Ch. VI, para 1(c).

[110] ibid, Part I, Ch. VI, Commentary on the Environment, para 64.

[111] OECD Watch, "Advocacy brief: Arguments for updating the OECD Guidelines to improve business standards on climate change and the environment" (February 2022). p. 2.

[112] ibid.

2.5 Approaches to dealing with corporate due diligence by countries

2.5.1 France

The French proposal for a due diligence regime on environment and human rights was debated by various stakeholders for over four years.[113] Importantly, civil society representations were highly involved in the negotiations. Yet, when negotiations were completed, the proposal had lost some if its teeth, much due to lobbing by various industry representatives.[114] Nevertheless, France was the first country to introduce legislation on human rights and environmental due diligence. The French "Vigilance Law" is a cross-sectorial due diligence law that came into force in 2017.[115]

To some extent, the Vigilance Law is similar to the United Nations Guiding Principles on Business and Human Rights and its due diligence procedure.[116] However, due to differences in legal traditions, French stakeholders have agreed that "vigilance" is the preferred term over "due diligence". Therefore, the term vigilance will be used when French law is discussed in this thesis.[117]

The scope of the Vigilance Law consists of three criteria. To be subject to the Vigilance Law, the company must have 5,000 employees in France or 10,000 employees worldwide, including employees in direct and indirect subsidiaries.[118] Further, the parent company must have its registered office in France and the company must have a specific company form.[119] French companies with foreign parent companies may also be covered by the scope of the Vigilance

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[113] Schilling-Vacaflor 2021, p. 115.

[114] ibid.

[115] Loi No 2017-399; Elsa Savourey's translation of the Vigilance Law has been used from the "French Country Report" in European Commission, Directorate-General for Justice and Consumers, Smit, L., Deringer, H., Salinier, C. (2020). (hereinafter Savourey 2020).

[116] ibid, p. 56-57.

[117] ibid.

[118] ibid, p. 60-61; Commercial Code, Article L. 225-102-4.-I para. 3.

[119] Company forms: "SA [*Sociétés Anonyme*], SCA [*Société en Commandite par Actions*], SE [*Société Européenne*]" from Savourey 2020, p. 61; Commercial Code, article L. 225-102-4.-I para. 3.

Law if the criteria mentioned are met.[120] In addition, it is to note that the scope is independent of the company's turnover.[121]

Companies that are covered by the scope of the Vigilance Law must draw up a so-called vigilance plan.[122] "The plan shall contain reasonable vigilance measures (…) adequate to identify risks and to prevent severe impacts (…) on (…) the environment, resulting from the activities of the company and of those companies it controls".[123]

However, as Mackie points out, nether "severe impacts" nor "environment" is defined in the Vigilance Law. Consequently, it is left for the courts to interpret and to determine the scope of these terms.[124] During the negotiations, the French Parliament and the French Government agreed that the terms should not be further specified. Instead, previously signed international agreements would be used as a basis for interpretation. According to the French Government, the focus was rather on identifying the core of the risk that may arise from the companies' activities.[125] Mackie provides a definition of "adverse environmental impact" that includes "significant damage to the environment", which is crucial to ensure that a person does not have to suffer harm in order for an environmental violation to be recognised.[126]

The vigilance plan should cover the parent company's activities, but also other entities that are under the direct or indirect control of the parent company. Such actors may be subsidiaries, subcontractors, suppliers or "with whom there is an established commercial relationship".[127] The plan thus has a broad coverage as regards subsidiaries and activities taking place outside French territory if they are controlled by the parent company. Thus, the Vigilance Law applies to companies through ratione personae.[128]

[120] Savourey 2020, p. 63.

[121] ibid, p. 61.

[122] Commercial Code, Article L. 225-102-4.-I.

[123] Savourey 2020, p. 61-61; Commercial Code, Article L. 225-102-4.-I para. 3.

[124] Mackie (2021), p. 37.

[125] Savourey 2020, p. 62-63.

[126] Mackie 2021, p. 6.

[127] Savourey 2020, p. 62; Commercial Code, article L. 225-102-4.-I para. 3.

[128] ibid, p. 61-61.

Stakeholders who may be affected by the company's activities should be consulted during the preparation of the vigilance plan.[129] In addition, the plan must be implemented effectively and then both the plan and its implementation must be made public. The company must also include this progress in its annual activity report.[130]

There are two different actions that can be taken if a company breaches the Vigilance Law. The first is injunctions, which can be brought by anyone with the right to bring an action. Consequently, anyone can have *locus standi*, including non-governmental organisations. The company has three months to fulfil the obligation it is in breach of, if the company still does not comply, the court may issue a periodic penalty order.[131]

The second action that can be taken against a company under the Vigilance Law is civil liability. The parent company is obliged to remedy all breaches of the obligations under the Vigilance Law that could have been averted if the company had complied with the law.[132] A civil claim can therefore be brought due to environmental damage caused by a subsidiary of the parent company. However, such a claim can only be based on the parent company's non-compliance of the Vigilance Law, not on the subsidiary's actions per se. For a claim to be successful, it must be possible to avert the damage that has occurred through a sufficient vigilance plan.[133]

However, to bring a civil claim, there is certain cumulative criteria to fulfil. First, the claimant has to prove a damage occurred. Second, the company must be in breach of one of the obligations under the Vigilance Law as outlined above. Finally, it must be proven that there is a connection between the damage and the non-compliance of the Vigilance Law. In addition, the burden of proof lies on the claimant.[134]

Parent companies may become liable for a breach that occur in a distant subsidiary of their value chain. However, it is up for the claimant to prove that there is an existing link between the violation and the non-compliance of the Vigilance Law. To bring evidence of such a link may be challenging for an individual, especially if this subsidiary is based in a foreign

[129] ibid, p. 69.

[130] Commercial Code, Article L. 225-102-4.-I.

[131] ibid, Article L. 225-102-4.-II; Mackie 2021, p. 38.

[132] Savourey 2020, p.68; Commercial Code, Article L. 225-102-5; Mackie 2021, p. 38.

[133] Savourey 2020, p.68

[134] ibid.

country.[135] Moreover, the idea behind the Vigilance Law is that companies should act to achieve a result. However, companies are not a required to actually reach the result. To clarify, what matters is that the company has taken sufficient action, not the actual result. Hence, environmental harm caused by a company is not necessary a violation of the Vigilance Law. It can therefore be considered somewhat unclear what a breach of the vigilance obligations actually entails.[136]

The aim of the Vigilance Law is *inter alia* to provide civil liability for persons who have suffered damage. Such an ambition includes the right for persons located outside France to have access to justice through French courts.[137] However, it can be difficult for foreign victims to access French courts, for example because of language differences, lack of knowledge of their rights or because they are unable to appear in French courts. Moreover, only the person with legal capacity can appear in court; one cannot be represented by, for example, a non-governmental organisation. In addition, the ability of such organizations to bring class action lawsuits is limited.[138] Consequently, it can be difficult for individuals to reach a civil settlement. The original aim was *inter alia* to reverse the burden of proof and thereby place a greater burden on companies.[139] A reversal of the burden of proof would have improved individuals' access to civil remedies.

2.5.2 Germany

German companies were first regulated through voluntary sustainability initiatives issued by the government. A survey was undertaken, and it was found that less than 25% of German companies followed the voluntary guidelines. In the light of this, it was decided to introduce a corporate due diligence law.[140] The German Act is inspired by the French Vigilance Law, and international standards but differs in many respects, as explained below. The German Act will come into force in 2023.[141]

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[135] Brabant and Savourey 2017, p. 3.

[136] ibid, p. 2-3.

[137] ibid.

[138] ibid, p. 3-4.

[139] Cossart et al. 2017, p. 317.

[140] Kolev and Neligan 2022, p. 8.

[141] Business and Human Rights Resource Centre "German parliament passes mandatory human rights due diligence law" (16 June 2021).

The scope of application of the German Due Diligence Act covers companies with more than 3,000 employees. This applies to both German and foreign companies.[142] There is no rule on the company form but German companies must have their central office or headquarters in Germany to be covered by the Act. Foreign companies are subject to the law if they have a German branch office.[143] The threshold is considerably higher than the threshold for companies operating in France. However, one year after the Act comes into force the threshold will be lowered to apply to companies with 1000 employees.[144] The German Due Diligence Act is expecting to cover around 900 companies in 2023 and 4800 companies in 2024.[145] It has been argued that such a high threshold is contrary to the United Nations Guiding Principles on Business and Human Rights, which apply to all companies.[146]

The German Due Diligence Act covers human rights risks and, to some degree, environmental risks. Nonetheless, the environmental extent is rather limited. The Act only applies to environmental risks covered by the "Minamata Convention on Mercury 2013, the Stockholm Convention on Persistent Organic Pollutants 2001 or the Basel Convention on Hazardous Wastes 1989."[147] In addition, the "risk of polluting soil, water and air if this leads to violations of the rights to food, water, sanitation and health" is covered by the environmental due diligence obligations.[148]

The French Vigilance Law obliges companies to draft a vigilance plan to identify risks and to prevent severe impacts from occurring. Similarly, German companies are obliged to adopt a policy, to identify risks and take preventive measures. In addition, German law requires companies to take measures to remedy environmental damage arising from the activities of the company and directly related entities.[149] The extent of the due diligence towards directly affiliated undertakings should be proportionate. Factors considered are the influence the

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[142] Bundesgesetzblatt Jahrgang 2021 Teil I Nr. 46, ausgegeben zu Bonn am 22. Juli 2021 über die unternehmerischen Sorgfaltspflichten zur Vermeidung von Menschenrechtsverletzungen in Lieferketten (Lieferkettensorgfaltspflichtengesetz (LkSG)) section 1.

[143] LkSG section 1; Krajewski et al. 2021, p. 553.

[144] ibid, p. 552.

[145] Federal Ministry for Economic Cooperation and Development "Supply Chain Law FAQs" (9 June 2021) p. 1.

[146] Krajewski et al. 2021, p. 553.

[147] ibid, p. 554; LkSG section 2(3).

[148] ibid.

[149] ibid; LkSG section 3(1).

company has over the responsible entity, the character and gravity of the risk, whether the risk can be reversed and the likelihood of its occurrence.[150] The German Due Diligence Act thus differs to some extent from the French Vigilance Law, as the vigilance plan applies to direct and indirect entities with which the parent company has an established business relationship**.**

Under the German Due Diligence Act, risks must be identified if they arise in the company's own activities or in the activities of its direct suppliers.[151] When a risk of environmental harm is acknowledged, the company should take steps to prevent harm from occurring, including through procurement, investment and contractual obligations. Such risks should be managed across the supply chain.[152] If environmental damage has already occurred, the company should effectively contain and terminate the damage.[153] It has been argued that the German Due Diligence Act has defined the supply chain too narrowly as it only includes direct suppliers and is therefore contrary to the international framework.[154] In addition to its own activities, the company is therefore only obliged to mitigate environmental damage from direct suppliers. However, it is unclear if subsidiaries that are not direct suppliers are covered by the Act.[155]

Important to note is however that the German due diligence law is an obligation of conduct, not of result. Which means that companies may not become liable for failure to achieve a certain outcome. Rather, the Act obliges companies to consider the obligations arising from the law.[156] Accordingly, stakeholder participation, such as communication with persons who may be affected by the company's activities, is mentioned in the Act but is not mandatory. This differs from the French law which obliges companies to consult with stakeholders while drafting their vigilance plan. However, German law requires companies to set up a complaints mechanism for environmental and human rights violations.[157] Lastly, in contrast to the French Vigilance Law, the German Due Diligence Act excludes civil liability.[158]

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[150] ibid; LkSG section 3(2).

[151] ibid; LkSG section 5.

[152] ibid; LkSG section 6.

[153] ibid; LkSG section 7.

[154] ibid, p. 555.

[155] ibid.

[156] LkSG section 3, para 1.

[157] Krajewskinnatio et al. 2021, p. 555.

[158] ibid, p. 553.

To conclude, internationally recognised frameworks such as the OECD Guidelines and the United Nations Guiding Principles on Business and Human Rights have played a great role in the development of corporate due diligence standards and have served as guidance and a basis for national due diligence legislation. Though, the emergence of due diligence in EU member states lead to a fragmented legal landscape that may create legal uncertainty and run counter to the EU's objective of creating a level playing field. As shown above, the French and German legal acts on due diligence differ, both from each other but also from the international framework. The EU has therefore prepared a proposal on corporate due diligence and sustainability which, if adopted, aims to harmonise due diligence legislation in EU member states. The next Chapter aims to assess the proposed EU Directive on Corporate Sustainability Due Diligence.

3 Proposed Due Diligence in the EU

Companies have been recognised as key players whose environmental behaviour has a major impact on the success of the EU Green Deal and the UN Sustainable Development Goals.[159] Current international tools, such as the United Nations Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises, require multinational companies to conduct due diligence. However, these voluntary instruments have proven to be insufficient in ensuring effective due diligence concerning human rights and the environment. Accordingly, the European Commission's study on due diligence in supply chains found that only 37.24% of the companies surveyed perform adequate due diligence on environmental and human rights issues.[160] Of those companies that do apply due diligence, only 16% apply due diligence in their supply chains.[161] Lastly, only 7.43% carry out due diligence on climate change.[162]

Against this backdrop the European Parliament issued a resolution for an EU Directive on Corporate Due Diligence and Corporate Accountability.[163] As a response to the Parliaments resolution, the Commission drafted a proposed EU Directive on Corporate Sustainability Due Diligence.[164] The purpose of the following sections is to describe and discuss the Commission's proposal with a focus on its environmental due diligence obligations.

3.1 Business statement

More than 100 companies, investors and business associations have issued an open statement calling on the EU to move ahead with its environmental and human rights due diligence proposal.[165] This was in response to the European Parliament's resolution on Corporate Due

[159] COM/2022/71 final, Explanatory Memorandum, p. 1.

[160] European Commission et al. (2020) p. 48.

[161] ibid.

[162] ibid.

[163] European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)).

[164] COM/2022/71 final.

[165] Business & Human Rights Resource Centre "More than 100 companies and investors call for effective EU corporate accountability legislation" (8 February 2022).

Diligence and Corporate Accountability.[166] The open letter stresses the importance of implementing the initiative and argues that it may lead to a paradigm shift. It was noted that the success of the proposal depends on its alignment with the already established international instrument in this field, such as the United Nations Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises.[167]

In particular, it was argued that the proposal should cover all companies throughout the EU, both those registered in any of the member states and those operating in the single market. The signatories recognised the impact that both small and large businesses have on the environment and human rights and that including all businesses could bring legal certainty and stimulate implementation across the value chain. They therefore argued that all companies should be covered by the Directive, even though some of the signatories are small and medium-sized enterprises (SMEs). Furthermore, they argued that the size and severity of the impact could be used as an indicator for SMEs due diligence responsibilities, in order to ensure proportionality and to avoid SMEs being overburdened by the implementation of measures.[168]

Further, it was declared that the action expected by a company in the event of environmental or human rights impact shall depend on the extent to which the company is involved in the damage. Thus, if the company is directly responsible for the damage, it should entail greater liability. On the other hand, if the company only contributes to the damage, less liability should be imposed, regardless of whether the damage occurs in the value chain or at its business partner. In addition, companies should be allowed to prioritise which actions to take towards their value chains and business partners based on the severity of the damage.[169]

The open statement points out that both business and civil society organisations want the Directive to have a real impact on environmental and human rights abuses rather than a "tic-box" approach. In addition, it was argued that stakeholder participation is essential for the Directive to have a meaningful impact. It is therefore important to take into account the views of the people who are actually affected by the potential harm that may result from companies'

[166] European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)).

[167] Business & Human Rights Resource Centre "More than 100 companies and investors call for effective EU corporate accountability legislation" (8 February 2022).

[168] ibid.

[169] ibid.

activities. Finally, the signatories declared that mechanisms for civil and administrative liability are needed to ensure effective implementation of the Directive.[170]

3.2 Subject matter, legal content and application scope of the proposed EU Directive on Corporate Sustainability Due Diligence

The proposed EU Directive provides rules:

> (a) on obligations for companies regarding actual and potential human rights adverse impacts and environmental adverse impacts, with respect to their own operations, the operations of their subsidiaries, and the value chain operations carried out by entities with whom the company has an established business relationship and
> (b) on liability for violations of the obligations mentioned above.[171]

The proposed Directive states that other obligations in the EU acquis that are more specific or comprehensive take precedence over the Directive.[172] In addition, the obligations under the proposed Directive are non-regressive, meaning that member states that have introduced more stringent human rights, environmental and climate protection measures are not allowed to lower their standards.[173]

At first sight, the proposed Directive provides a rather broad application. The Directive provides rules not only for companies' own environmental effect but also for subsidiaries and entities in their value chain. However, according to the definition of "adverse environmental impact", the Directive only applies to the environmental effects listed in Part II of the Annex.[174] The Annex outlines objectives of environmental conventions, biodiversity protection, waste management, chemicals and endangered species. In addition, the Annex includes the protection of ozone-depleting substances, but not greenhouse gases, which are essential to address in order to be in line with the Paris Agreement.[175]

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[170] ibid.

[171] COM(2022) 71 final, Article 1.

[172] ibid, Article 1(3).

[173] ibid, Article 1(2).

[174] ibid, Article 3(b).

[175] European Coalition for Corporate Justice "European Commission's proposal for a directive on Corporate Sustainability Due Diligence A comprehensive analysis" (5 April 2022), p. 17.

The scope of the due diligence obligations under the proposed Directive depends on the nature of the relationship between the company and its business relations. As seen above, the notion of an "established business relationship" is used as a benchmark for due diligence.[176] The determining factors of whether the relationship is "established" or not depend on its "duration" or "intensity" which indicates how "lasting" the relationship is or may become.[177] The link may be direct or indirect but the entity must not be insignificant in the value chain.[178] This model focuses on the business relationship between the entities rather than on the actual or potential risk of environmental harm. The level of due diligence that can be applied therefore depends on how much influence companies have over their business relationships.[179] By contrast, it has been argued that the application of due diligence is more effective if it is adapted to the seriousness of the risks and potential impacts of the activity.[180] This is in accordance with international standards and is supported by Ruggie who argues that the use of leverage is an unstable basis for corporate responsibility.[181]

The proposed Directive applies to companies operating within the EU and, to some extent, outside the EU. Article 2 of the proposed Directive defines the scope of application. Accordingly, companies with over 500 employees and a "net worldwide turnover of more than EUR 150 million" worldwide in the last year are covered. In addition, certain companies operating in high-risk sectors such as textiles[182], agriculture, forestry, fisheries[183] and mining[184] may be covered by the scope of the proposed Directive. The Commission has pointed out that the sectors classified as risk sectors correspond to the specific risk sectors for which the OECD

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176 COM(2022) 71 final, Article 3(f).

177 ibid.

178 ibid

179 Shift "The EU Commission's Proposal for a Corporate Sustainability Due Diligence Directive: Shift's Analysis" (March 2022), pp. 4-5.

180 ibid.

181 UN Human Rights Council, *Protect, respect and remedy : a framework for business and human rights : report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, John Ruggie*, 7 April 2008, A/HRC/8/5, para 72.

182 COM(2022) 71 final, Article 2(1)(b)(i).

183 ibid, Article 2(1)(b)(ii).

184 ibid, Article 2(1)(b)(iii) The origin of mineral resources does not affect the application of the Directive.

has developed specific guidelines. However, the OECD has also developed guidelines for the financial sector, which are not covered by the Directive.[185]

For companies acting in risk sectors, there is a threshold of at least 250 employees and a worldwide net turnover of at least EUR 40 million with 50% being generated in said risk sectors.[186] The proposed Directive also applies to companies registered outside the EU in the following cases: if the company has generated a net turnover over EUR 150 million in the EU in one year[187]; or if a net turnover of at least EUR 40 million and no more than EUR 150 million is generated in the EU and 50% of the activity is in a risk sector.[188] The company's worldwide net sales are included in the calculation of the risk sector business and not only the revenues generated in the EU.[189] Only one of the criteria must be met for non-EU companies to fall within the scope of the proposal. Hence, the proposed Directive has an extraterritorial scope. In addition, it is horizontal, which means that it applies to all companies in all sectors without reservation, if the criteria mentioned are met.

The extraterritorial reach of the proposed Directive may have a great effect on companies that are registered outside the EU**.** However, the Commission has estimated that only around 13,000 companies in the EU and around 4,000 companies in third countries will be subject to the Directive.[190] The proposal makes no distinction between private and publicly owned companies, which makes it possible to impose due diligence obligations on both. Yet, SMEs will not be covered by the Directive and therefore not by its due diligence requirements. SMEs represent 99% of companies in the EU, which means that only 1% of companies operating in the EU could be covered by the proposed Directive.[191]

The thresholds for number of employees and net turnover are based on the parent company and not on a group level. This differs from the way in which such thresholds have been measured

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[185] Shift "The EU Commission's Proposal for a Corporate Sustainability Due Diligence Directive: Shift's Analysis" (March 2022), p. 9; COM(2022) 71 final p. 15; see the OECD website for more information about due diligence in the financial sector <http://mneguidelines.oecd.org/rbc-financial-sector.htm>

[186] COM(2022) 71 final, Article 2(1)(b).

[187] ibid, Article 2(2)(a).

[188] ibid, Article 2(2)(b).

[189] ibid

[190] COM(2022) 71 final, Explanatory memorandum p. 16.

[191] ibid, p. 14.

in the Non-Financial Reporting Directive[192], where the thresholds are based on the whole group rather than on a separate entity. Multinational companies that only meet the threshold if all subsidiaries are included will thus be excluded from the scope.[193] There is a risk that entities close to the threshold will simply set up new subsidiaries to avoid due diligence obligations, which could lead to further fragmentation of the global market.[194] Arguably, the number of employees in the group represents the power and influence of a multinational company more than the number of employees in the parent company.[195]

The Commission has justified the decision to exclude SMEs from the scope of Article 2 based on proportionality. It claims that the financial and administrative burden on SME of establishing an adequate due diligence policy would simply be too great.[196] However, it has been argued that the size or number of employees of a company is not necessarily the most accurate indicator of which company has the greatest impact on human rights, the environment or climate change.[197] An example of this is Hilcorp Energy Co, an oil and gas company that emits 50% more methane gas than ExxonMobil, one of the world's largest oil companies.[198]

Larger companies usually have a greater impact on the environment. However, this does not mean that SMEs have no impact on the environment at all. According to the Commission, SMEs have an annual turnover of between €10 million and €50 million and employ between 50 and 250 people.[199] Exempting such companies from the obligation of due diligence ignores the potential cumulative effects that these companies may have on the environment. The cumulative effects of several SMEs may be greater than the effects of large companies in the

[192] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups [2014] OJ L330/1. (Non-Financial Reporting Directive).

[193] University of Oxford Faculty of Law "The EU Proposal on Corporate Sustainability Due Diligence and the Mystique of Complete Corporate Separateness" (11 April 2022).

[194] ibid.

[195] European Coalition for Corporate Justice "European Commission's proposal for a directive on Corporate Sustainability Due Diligence A comprehensive analysis" (5 April 2022), p. 7.

[196] COM(2022) 71 final, Explanatory memorandum p. 14-15.

[197] Gözlügöl and Ringe (2022) p. 9.

[198] ibid; Nevertheless, both companies are large enough in terms of net turnover and employees to be covered by the Directive.

[199] European Commission "SME definition"; COM(2022) 71 final, Article 3(i), the proposed Directive classify SME as all businesses that are not covered by Article 3(1), (2), (3) and (7).

same sector. In the UK, for example, SMEs alone account for around 70% of industrial pollution.[200] In addition, the proposal stresses the importance of life-cycle analysis of human rights and environmental issues in order to carry out effective due diligence.[201] Therefore, to carry out a comprehensive life cycle assessment for sustainable development, it can be argued that more than 1% of the companies operating in the EU should be included in such an assessment.

The Commission's proposal refers to the OECD Guidelines on Multinational Enterprises and the United Nations Guiding Principles on Business and Human Rights as international standards which the proposal aims to be consistent with. However, both international frameworks are applicable to companies, regardless of sector.[202] Instead, other factors are measured, such as size, nature of the business and risk, making it possible to determine the due diligence obligations of SMEs.[203] The proposed Directive, on the other hand, is only applicable to large companies on a cross-sectoral basis and is limited to the risk sectors of textiles, agriculture, forestry, fisheries and mineral extraction. This approach to regulating the scope of the proposed Directive may undermine the common obligation that motivates companies to comply with due diligence rules.[204]

3.3 Specific obligations under the proposed Directive

3.3.1 Climate change action plan

Companies falling within the scope of the proposed Directive are required to prepare a climate change action plan. However, companies that are covered only because they are active in one or more risk sectors are exempted from this obligation. This applies regardless of where the company operates.[205] To meet this obligation, companies must ensure that their policies are in line with the Paris Agreement and its target of a maximum temperature increase of 1.5 degrees

[200] Seidel-Sterzik et al. (2018), p. 4.

[201] COM(2022) 71 final, Recital 17.

[202] United Nations Guiding Principles on Business and Human Rights (2011), General Principles, p. 1; OECD (2018), *OECD Due Diligence Guidance for Responsible Business Conduct.*

[203] OECD Guidelines for Multinational Enterprises (2011) Part I, Ch. I, Commentary on General Policies para 15.

[204] Shift "The EU Commission's Proposal for a Corporate Sustainability Due Diligence Directive: Shift's Analysis" (March 2022); COM(2022) 71 final, pp. 9-10.

[205] COM(2022) 71 final, Article 15(1).

Celsius. In addition, an assessment must be carried out to investigate potential climate change risks, if such risks are detected, emission reduction targets must be incorporated into the policy.[206] The scope of the provision is limited as it only applies to large companies, not to companies operating in risk sectors. Moreover, the requirement is only to establish a climate plan, there is no obligation to execute the plan. In addition, one of the values of the proposed Directive is to achieve sustainability through business value chains. Arguably, climate change mitigation is a key factor in achieving this goal because of its impact on human rights, the environment and the global economy. However, the proposed Directive only requires companies to draw up plans for their activities, which has been interpreted as covering only direct emissions, not indirect emissions.[207]

This contrasts with recent developments in climate litigation. The issue was raised in the Shell case on corporate responsibility for climate change.[208] The decision in the case was in line with the United Nations Guiding Principles on Business and Human Rights, holding Shell responsible for direct and indirect emissions. In addition, Shell was held accountable for "all other indirect emissions resulting from activities of the organization (…) owned or controlled by third parties", including consumers.[209] This was especially important since 85% of Shell's emissions came from such sources.[210] Accordingly, Shell was ordered to decrease their emissions to 45% at 2030 compared to 2019 levels.[211]

3.3.2 Directors duty of care

The directors[212] duty of care is laid down in Article 25 of the proposed Directive. Thus, in discharging their duty, directors are required to "take into account (…) sustainability issues, including, where appropriate, human rights, climate change and environmental impacts" in their decision-making.[213] This duty is rather weak, as directors only has to consider such impacts,

[206] ibid, Article 15(2).

[207] European Coalition for Corporate Justice "European Commission's proposal for a directive on Corporate Sustainability Due Diligence A comprehensive analysis" (5 April 2022), p. 18.

[208] Rechtbank Den Haag, 26-05-2021 / C/09/571932 / HA ZA 19-379 / ECLI:NL:RBDHA:2021:5339.

[209] ibid para 2.5.4., 5.3.

[210] ibid para 2.5.5.

[211] ibid para 5.3.

[212] COM(2022) 71 final, Article 3(o), definition of director.

[213] ibid, Article 25(1).

not act on them.[214] As stated in Recital 63, the proposed Directive does not aim to change any "national corporate structures", but only to clarify existing obligations.[215] Consequently, it remains a national competence to determine the duties of directors and the overarching standards of corporate governance.[216] However, it is the responsibility of the director to establish and oversee due diligence. Directors should therefore ensure that a due diligence policy is in place and that risks are adequately identified, prevented, mitigated and addressed.[217]

3.3.3 Due diligence

The due diligence requirements laid down in the proposed Directive are set out in Article 4. Consequently, in order to fulfil their due diligence obligations, companies must comply with the obligations provided for in Articles 5 to 11 of the Directive.[218] Responsibility for due diligence is placed on the state rather than on the company itself, since the state is responsible for ensuring that companies carry out due diligence.[219] The due diligence required by the proposed Directive is presented below.

Accordingly, companies shall introduce a specific due diligence policy[220] to be reviewed annually.[221] Article 5 provides cumulative criteria for the content of the due diligence policy.[222] The company should provide an outlook of the policy together with its long-term strategies.[223] A code of conduct shall be drawn up containing the rules and principles intended for employees and subsidiaries.[224] The company's due diligence process should be described along with its compliance measures and how the company plans to implement the policy in its established relationships.[225] To monitor and keep the due diligence policy up to date, the company shall

[214] Harvard Law School Forum on Corporate Governance "The EU Sustainable Corporate Governance Initiative: Where are We and where are We Headed" (18 March 2022).

[215] ibid.

[216] ibid.

[217] COM(2022) 71 final, Article 26.

[218] ibid, Article 4(1)(a)-(f).

[219] ibid, Article 4(1).

[220] ibid, Article 5(1).

[221] ibid, Article 5(2).

[222] ibid, Article 5.

[223] ibid, Article 5(1)(a).

[224] ibid, Article 5(1)(b).

[225] ibid, Article 5(1)(c).

conduct an annual review of its activities and performance and update the policy as necessary.[226]

Companies shall take "appropriate measures" to identify actual and potential adverse effects.[227] The measures should be proportionate to the severity and likelihood of adverse effects and should be assessed and prioritised on a case-by-case basis, considering the influence of businesses.[228] Such measures should be used to identify risks to human rights and the environment. The risk may be a result of the company's own activities, its subsidiaries, or by an entity "related" to the value chain. The concept of established business relationship as explained above is used as a benchmark to trigger the obligations. Companies covered by the Directive because they operate in risk sectors only need to disclose actual and potential serious negative effects related to the risk sectors.[229] To reveal the potential risk, stakeholders can be consulted if the company considers it relevant.[230]

If a potential risk of impact on the environment or human rights has been identified in accordance with Article 6, the undertaking must take "appropriate measures" (as described above) to prevent the harm from arising.[231] If the company cannot prevent the damage from occurring, it must take mitigation actions.[232] Investments in different parts of the business may be necessary to meet such requirements.[233] In order for companies to effectively prevent harm from occurring they may establish a prevention action plan including a timeline to measure progress. This plan should be drafted in collaboration with stakeholders.[234] If there is no established business relationship, but a direct link between the company and other entities in the value chain, a contractual assurance of compliance can be established for compliance with the company's code of conduct.[235] Once such a contractual relationship has been established, a

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226 ibid, Article 10.

227 ibid, Article 6(1).

228 ibid, Article 3(q).

229 ibid, Article 6(2).

230 ibid, Article 6(4); Stakeholder participation is elaborated on in more detail below.

231 ibid, Article 7(1), Companies are obliged to act even if the risk has not been identified under Article 6, but should have been identified.

232 ibid, Article 7(1).

233 ibid, Article 7(2)(c).

234 ibid, Article 7(2)(a).

235 ibid, Article 7(2)(b).

method for auditing, such as third-party validation or sector-specific validation, should be put in place.[236]

As outlined above, SMEs are not directly covered by the scope of the Directive. However, as the Directive obliges companies to take due diligence action against the environmental impacts that may arise in their subsidiaries or in their value chain, SMEs are indirect covered by the Directive.[237] But parent companies are obliged to provide support to SMEs if the burden of compliance is too great.[238] If these measures are not sufficient to prevent or mitigate the harm, companies should seek to enter into a contractual relationship with the indirect entity to achieve compliance with the code of conduct together with control measures.[239] If the company fails to prevent and mitigate the damage through these measures, the last resort is to suspend or terminate the business relationship with regard to the entity causing the damage.[240]

Article 8 of the proposed Directive lays down an obligation for companies to ensure that actual adverse effects are eliminated. If the company is unable to stop the ongoing negative impact, it should at least minimise the damage caused.[241] Accordingly, companies should do the following actions to end or minimise the harm. Where companies have an established business relationship with another entity, a contractual assurance should be drawn up to ensure compliance with the parent company's code of conduct and action plan if needed[242], and should be accompanied by control measures.[243] The signatory should also enter into similar agreements with the entities in its value chain.[244] If a corrective action plan is necessary, companies should consult stakeholders before drafting it.[245] Cooperation between entities may be necessary to stop ongoing damage.[246] Investment may also be needed to end or minimise the

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[236] ibid, Article 7(4).

[237] ibid, Article 1(1)(a), The parent company must have an established business relationship with the entity for the obligation to arise.

[238] ibid, Article 7(2(d).

[239] ibid, Article 7(3).

[240] ibid, Article 5(a) and (b).

[241] ibid, Article 8(2).

[242] ibid, Article 8(3)(c).

[243] ibid, Article 8(5).

[244] ibid, Article 8(3)(c).

[245] ibid, Article 8(3)(b).

[246] ibid, Article 8(3)(f).

damage.[247] Minimising damage also means paying proportionate compensation to affected individuals and communities.[248] In addition, assistance to SMEs may be needed for them to comply with the code of conduct of the parent company.[249] If the damage cannot be remedied by any of the aforementioned measures, the company shall terminate the contract with the entity temporarily or permanently.

Companies that are covered by the scope of the Directive are expected to apply due diligence in their own activities and also in their value chain and subsidiaries. To achieve such an objective Article 7 and 8 are in a consistent way obliging companies to use contracts to bring the directly connected entities into compliance with their code of conduct. Hence, the Directive relies on the established business relationship between the entities as the basis for preventing, mitigating, ending and minimising adverse impact. Therefore, to achieve implementation of due diligence measures in the value chain and in the subsidiaries, the company must exercise its influence over these entities. When companies have such leverage over other entities, there is a risk that SMEs will suffer the costs of implementing these measures. As outlined above, the Directive does mention that SMEs may need support in order to implement the measures necessary to be in line with the company's code of conduct, but only if the implementation would "jeopardise the viability of the SME".[250] In addition, the Directive mentions that the parent company should bear the burden of the cost of the verification measures for upholding the code of conduct.[251] There is still a risk that the cost will be passed down the value chains and that SMEs will have to bear the burden of introducing such measures.[252]

The Directive allows the parent company to withdraw from contractual business relationships where potential adverse impact cannot be prevented or mitigated[253] in accordance with Article 7(2), (3) or (4) or when actual adverse impact cannot be eliminated by the measures provided for in Article 8(3), (4) or (5). However, it is not clear whether the article still applies if the negative consequences would worsen if the business relationship were to end.[254] Moreover, the

[247] ibid, Article 8(3)(d).

[248] ibid, Article 8(3)(a).

[249] ibid, Article 8(3)(e).

[250] ibid, see 7(2)(d) and 8(3)(e).

[251] ibid, Article 8(5) para 2.

[252] Remissyttrande Dnr V 2022/546, p. 2.

[253] COM(2022) 71 final, Article 5.

[254] Remissyttrande Dnr V 2022/546, p. 2.

Directive only refers to the signing of the company's code of conduct or, where applicable, a corrective action plan by its subsidiaries or value chain entities. However, there is no further guidance on what such a code of conduct or plan should contain.

3.3.4 Stakeholder participation, complaint procedure and liability

The proposed Directive provides for stakeholder participation. Article 6 sets out the conditions for identifying actual and potential adverse effects.[255] Thus, companies are obliged to consult stakeholders and other groups likely to be affected by their activities, but the Directive only requires consultation of potentially affected parties when the company itself considers it relevant.[256] This obligation is not as extensive as the OECD Guidelines, which call for broader participation by involving stakeholders in plans and decisions in order to have a relevant influence.[257] The risk of letting the company decide when to consult stakeholders is that companies' views on when it is appropriate to consult stakeholders may vary between companies. It can also be used as an excuse for not consulting potentially vulnerable groups or doing so only in specific authorisation procedures[258]. Stakeholders such as indigenous people or remote communities often have valuable knowledge about the environment and their surroundings. Failure to consult with stakeholders may therefore result in the company not receiving sufficient information and therefore not detecting the risk posed by their activities, making it impossible for the company to meet their due diligence obligations[259]. In addition, if the potential negative consequences of the company's activities cannot be identified under Article 6, it is of little affect that Article 7(2)(a), "where relevant", lays down an obligation for companies to draw up a preventive action plan in conjunction with the affected stakeholders.

In addition, the proposed Directive makes no reference to stakeholders in the monitoring obligations[260]. Contrary to the OECD Guidelines that prescribe responsibility of the company to stakeholders in terms of monitoring.[261] Stakeholders are not included in the communication

[255] COM(2022) 71 final, Article 6.

[256] ibid, Article 6(4).

[257] OECD Guidelines for Multinational Enterprises (2011) Part I, Ch. II, para 14.

[258] Shift "The EU Commission's Proposal for a Corporate Sustainability Due Diligence Directive: Shift's Analysis" (March 2022), p. 8.

[259] ibid, p. 6-7.

[260] COM(2022) 71 final, Article 10.

[261] OECD Guidelines for Multinational Enterprises (2011) Part I, Ch. II, Commentary on General Policies, para 8.

either.[262] Thus, companies have no specific requirement to communicate with stakeholders about activities that affect them, but are only obliged to prepare a formal report concerning risk and due diligence measures.[263] However, companies must publish information on their due diligence measures and policies on their website disclosing potential and actual negative impacts. The Commission will provide further guidance on this publication.[264]

Companies shall establish a complaints procedure that allows individuals and organisations to lodge complaints about adverse environmental or human rights impacts with the company.[265] One can complain about both potential and actual negative effects of the company.[266] Though, there are certain requirements as to who may submit a complaint. In order for a person to file a complaint, he or she must be directly affected or believed to be affected by the negative impact arising out of the company's activities.[267] In addition, trade unions or representatives may represent workers in the value chain.[268] Relevant civil society organisations may also lodge a complaint.[269] The company shall establish a procedure for receiving and evaluating complaints. If there are grounds for the complaint, any environmental or human rights risks shall be identified in accordance with Article 6.[270] In addition, the complainant can request a follow-up[271] and discuss the matter with the company representative.[272] It has been argued that the complaint procedure should be revised to become more in line with principle 31 of the UN Guiding Principles that provides criteria for non-judicial grievance mechanisms.[273] Accordingly, complainants should be the focus and have an influence on how best to solve the

[262] COM(2022) 71 final, Article 10, Article 11; Shift "The EU Commission's Proposal for a Corporate Sustainability Due Diligence Directive: Shift's Analysis" (March 2022) p. 8.

[263] Shift "The EU Commission's Proposal for a Corporate Sustainability Due Diligence Directive: Shift's Analysis" (March 2022), p. 8.

[264] COM(2022) 71 final, Article 11.

[265] ibid, Article 9(1).

[266] ibid, Article 9(1).

[267] ibid, Article 9(2)(a).

[268] ibid, Article 9(2)(b).

[269] ibid, Article 9(2)(c).

[270] ibid, Article 9(3).

[271] ibid, Article 9(4)(a).

[272] ibid, Article 9(4)(b).

[273] United Nations Guiding Principles on Business and Human Rights (2011) Principle 31; Sveriges Advokatsamfund R-2022/0626.

problem.[274] According to the definition of "companies" provided by the Directive it can be argued that the obligation to establish such a complaints mechanism applies to all entities in a group which meet the criteria set out in Article 2(1).[275] It is therefore questionable whether it is proportionate that all companies in a group covered by the Directive have to set up their own complaint mechanism.[276]

Member states have a discretion to determent the sanctions they can impose on companies that do not to comply with due diligence requirements. However, sanctions must be "effective, proportionate and dissuasive" and effectively implemented.[277] The level of penalties should be determined by the efforts made by the company to comply with the Directive.[278] If a company is subject to sanctions, this information shall be made public.[279] The member states discretion may undermine the level playing field as penalties for infringements may vary between member states, creating different incentives to comply with the provisions of the Directive.

Article 22 outlines the conditions for civil liability. It is up to the member states to make sure that companies are liable for damages if the following cumulative conditions are met:

> (a) [the company] failed to comply with the obligations laid down in Articles 7 *and* 8 and;
> (b) as a result of this failure an adverse impact that should have been identified, prevented, mitigated, brought to an end or its extent minimised through the appropriate measures laid down in Articles 7 and 8 occurred and led to damage.[280]

This indicates that a company cannot be held liable for damages if the company are in breach of Article 7 and not Article 8. In addition, the proposed Directive gives companies a lower level of compliance if one of their established business relationships is classified as an "indirect partner" and they have taken sufficient due diligence action.[281]

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[274] ibid.

[275] ibid.

[276] ibid.

[277] COM(2022) 71 final, Article 20(1).

[278] ibid, Article 20(2).

[279] ibid, Article 20(4).

[280] ibid, Article 22(1)(a) and (b), emphasis added.

[281] ibid, Article 22(2); The company must have fulfilled the obligations of Article 7(2)(b), 7(4) or 8(3)(c) and 8(5) to avoid liability.

To conclude, the proposed Directive provides rather weak stakeholder engagement comparing to the OECD Guidelines and the UN Guiding Principles. In addition, due diligence obligations are dependent on the business relationship between parent company and other associated entities instead of using a risk-based approach as set out in the UN Guiding Principles. The limitation of size and risk sectors is another element of the Directive which is contrary to the international framework, but which will have a major impact on the implementation of the proposed Directive, especially since large companies represent only 1% of the companies in the EU.

In addition, there are many new terms in the Directive. It has been argued that the existing international legal framework contains terms that are well established and used in practice and would therefore be more suitable for use.[282] For example, the terms “causing, contributing and directly linked” are all terms that are widely used in the OECD Guidelines. They could therefore be used in the proposed Directive as well, in particular in Article 7 and 8. Such terms have also been used at national level. Introducing new terms is therefore somewhat counterproductive to the harmonisation that the EU aims to achieve.

[282] Sveriges Advokatsamfund R-2022/0626.

4 Implications of Pending EU Due Diligence Legislation on Corporate Due Diligence Requirements in Sweden

4.1 Relevant Swedish legislation

The Swedish government has recognised that Swedish companies should comply with international frameworks such as the OECD Guidelines for Multinational Enterprises, the United Nations Guiding Principles on Business and Human Rights and the United Nations Global Compact.[283] In addition, the Swedish government has declared the importance of not causing environmental impact outside Sweden.[284]

However, there are no specific environmental or human rights due diligence laws. Yet, there are certain laws that regulate corporate structures and reporting. There is also Swedish environmental legislation that regulates the behaviour of Swedish companies. The purpose of the following Chapter is to first analyse whether there is an obligation for companies to exercise environmental due diligence under Swedish law and then examine the potential impact of the proposed Directive on Corporate Sustainability Due Diligence on Swedish legislation and activities of Swedish companies.

4.1.1 The Swedish Companies Act

Swedish companies are mainly regulated by the Swedish Companies Act[285], which governs both private and public limited liability companies.[286] The core value of the Swedish Companies Act is that shareholders are not personally liable for the company's actions.[287]

The purpose of a company is used as an overall objective for the decision-making bodies. If the purpose is solely to make a profit, the board or the chief executive cannot take decisions that are not directed towards the profit objective.[288] In addition, if the purpose of a company's

283 Government Office of Sweden "Sustainable business – a platform for Swedish action" Reference No.: UD 13.031 (17 May 2015), p. 6.

284 ibid, p. 23.

285 Aktiebolagslagen (2005:551) (Companies Act) unofficial translation.

286 Companies Act, Ch. 1 section 2.

287 ibid, Ch. 1 section 3.

288 Skog 2020, p. 27.

activities is to be wholly or partly non-profit, this must be stated in the articles of association.[289] The provision thus implies that the basic purpose of a limited liability company is to generate profits for its shareholders, as confirmed by the preparatory works.[290] Nonetheless, it opens up the possibility that a company may have objectives other than purely economic ones. The inclusion of a non-economic purpose in the articles of association, however, requires a majority vote, which must be taken at the annual general meeting.[291] The preparatory works state that other purposes of limited liability companies may be political, scientific, cultural or charitable.[292] Though, such other purposes are quite rare, and if they exist, they usually exist in public companies.[293]

The Swedish Companies Act does not currently contain any due diligence requirements for companies. As stated above, a company may include other purposes than generating profits, if the conditions for such purposes are met. Such objective could then be environmental protection. However, even if the company only has an economic purpose per se, it has been argued that other factors may need to be met to achieve an economic objective.[294] *Inter alia*, sustainability can be an important factor in a company's reputation. Therefore, if a company implements a sustainability policy, including environmental protection measures, it may affect whether it achieves its profit target. It may even be a requirement of the profit motive to introduce such measures.[295]

Companies must also comply with other regulations in areas such as the environment.[296] In addition, companies can go beyond the guidelines and obligations imposed by national and international standards, e.g. with regard to the environment, sustainability and climate, as long as they do so within the scope of the company's purpose.[297] It may therefore not be necessary to implement other purposes in order for a company to carry out their activities in line with,

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[289] Companies Act, Ch. 2 section 3.

[290] Prop. 1975:103 s. 476.

[291] Companies Act, Ch. 7 section 43 p. 1.

[292] Prop. 1975:103 s. 476.

[293] Skog 2020, p. 26.

[294] ibid, p. 29.

[295] ibid, p. 30.

[296] ibid, p. 29.

[297] ibid.

inter alia, sustainable development or, environmental norms. Yet, this is something that has to be initiated by companies on a voluntary basis.

4.1.2 The Swedish Annual Accounts Act

As a result of the transposition of the EU Non-Financial Reporting Directive, various provisions on reporting obligations for companies were incorporated into the Swedish Annual Accounts Act.[298] The preamble to the Non-Financial Reporting Directive states that only large companies (with more than 500 employees) of public interest should be covered by the Directive. Hence, SME was excepted from the reporting requirement laid down in the Directive.[299] Sweden, however, has chosen to go beyond the minimum requirements of the Directive and introduced a lower threshold for the reporting obligations.[300]

The Annual Accounts Act sets the thresholds for which companies are required to report on their sustainability performance.[301] Accordingly, companies that had more than 250 employees, a balance sheet of more than SEK 175 million or an annual turnover of SEK 350 million in the last two years may be cover by the scope of the Annual Accounts Act.[302] The criteria are not cumulative, but companies must meet more than one of the criteria to be covered by the Act.[303] The lowering of the threshold to companies with 250 employees resulted in more than 1600 companies being subject to the reporting obligation compared to the 100 covered by the scope of the Directive.[304]

Parent companies shall prepare a report on the sustainability performance of the entire group.[305] Thus, even if a subsidiary meets the criteria, it does not have to provide its own report, as long as its activities are covered by the parent company's report.[306] The parent company shall disclose information on sustainability and provide comprehensive information on its operations, future prospects and its business activities impacts, in particular on environmental,

[298] Unofficial translation of the Swedish Årsredovisningslag (1995:1554) (Annual Accounts Act).

[299] Non-Financial Reporting Directive, Preamble, para 14, see also Article 19a and 29a.

[300] The Annual Accounts Act (1995:1554) Ch. 6 section 10.

[301] ibid.

[302] ibid, Ch. 6 section 10 pp. 1-3.

[303] ibid, Ch. 6 section 10.

[304] Svenskt Näringsliv ”Erfarenheter av hållbarhetsrapportering” (26 February 2021).

[305] The Annual Accounts Act, Ch. 7 section 31a.

[306] ibid, Ch. 6 section 10 para 2.

human rights and other social impacts.[307] The report shall contain information on the sustainability of the company to the extent necessary to understand *inter alia* the development and impact of the company's activities.[308] The preparatory works suggest that factors to include in the report may be the company's energy use, emissions, usage of natural resources, climate impact and the level of compliance with the Parliament's environmental quality objectives and the intergenerational target.[309] This then forms the basis of the disclosure obligation, which is determent on a case-by-case basis, with the nature of the company's operations in mind.[310] In addition, reporting should be based on the interests of stakeholders rather than on companies judgment.[311]

Expressly, the report should include the business model and the company's sustainability policy as well as information on the review and outcome of the policy. The preparatory work refers to due diligence as a review process to achieve the company's sustainability goals with regard to the policy. In addition, the companies risk procedure, including what risks exist and how are they are managed should be included. Risks of adverse impact may arise from the operations of the parent company or any of its business relationships activities.[312] The report should also include information on the measures taken by the company to identify, prevent and mitigate potential negative impacts, in supply chains and sub-supply chains.[313] The report shall be made available to the public, either together with the management report or by publishing it on the company's website.[314]

However, companies are not obliged to have polies in place in all areas if they consider it unnecessary with regard to the risk that may exist.[315] If the company does not have a policy in a particular area, it should justify why.[316] Hence, companies are not required to have a

[307] ibid, Ch. 6 section 12 para 1.

[308] Prop. 2015/16:193, p. 66.

[309] ibid.

[310] ibid.

[311] ibid.

[312] The Annual Accounts Act, Ch. 6 section 12 paras 1-6.

[313] Prop. 2015/16:193, p. 66.

[314] The Annual Accounts Act, Ch. 8 section 15a.

[315] Svenskt näringsliv, ”FAQ: Vad innebär lagen om hållbarhetsrapportering?”.

[316] The Annual Accounts Act Ch. 6 section 12 para 3.

sustainability or environmental policy, only to report on such if they do. In addition, there is no guidance on whether there are more or less legitimate reasons for not having a policy.

Nevertheless, the Annual Accounts Act allows for parent companies covered by the Act to include a due diligence mechanism for risks of adverse environmental impacts as a part of their policy. Due diligence may then be exercised both on the parent company's activities and of its business relationships. If such a mechanism exists, the parent company must report on the risks of adverse effects and how they are being managed. Though, as previously stated, there is no requirement for the parent company to have such a policy in place.

4.1.3 The Swedish Corporate Governance Code

Companies listed on Nasdaq Stockholm or NGM Equity are governed by the Swedish Code of Corporate Governance (the "Code") in addition to other corporate law.[317] Two main purposes are outlined in the Code: firstly, to increase confidence in Swedish companies by encouraging improved corporate governance and, secondly, to provide companies with a voluntary support system instead of binding legislation.[318] The Code is applied according to the "comply or explain" principle. This means that companies are not obliged to follow all the instructions in the Code, but when they choose to deviate from it, they must justify why.[319]

The obligations set out in of Chapter III section 10 of the Code are mandatory and therefore companies cannot deviate from them. In brief, companies are obligated to communicate how they have applied the Code in a governance report. The report must specify which provisions the company has or has not complied with, with an explanation; if the company has chosen other solutions, these must be specified and justified.

In addition, there is a Corporate Governance Board established to foster sound corporate governance. However, the board believes that guidelines and recommendations are preferable to binding legislation.[320] Thus, the Code is only intended to act as a complement to provide guidance to companies. In addition, the Board has no power to audit individual companies on

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[317] Swedish Corporate Governance Board "The Swedish Corporate Governance Code" consolidated version including instruction 1-2020.

[318] The Swedish Corporate Governance Code, Ch. I. para 1.

[319] ibid, Ch. III.

[320] ibid, Ch. I para 1.

the application of the Code.[321] This demonstrates the trust and importance placed on soft law and self-regulation of companies in Sweden. Consequently, the Code does not require listed companies to carry out due diligence, either on Swedish companies or on their value chains.

4.1.4 The Swedish Environmental Code

The Swedish Environmental Code contains rules on the environment and sustainable development for anyone who operates or intends to operate a company. [322] Accordingly,

> The purpose of this Code is to promote sustainable development which will assure a healthy and sound environment for present and future generations. Such development will be based on recognition of the fact that nature is worthy of protection and that our right to modify and exploit nature carries with it a responsibility for wise management of natural resources.[323]

The Environmental Code shall therefore be applied to protect human health and the environment.[324] The Code then describes its application, i.e. how sustainable development can be achieved.[325] Accordingly,

> 1. human health and the environment are protected against damage and detriment, whether caused by pollutants or other impacts;
> 2. valuable natural and cultural environments are protected and preserved;
> 3. biological diversity is preserved;
> 4. the use of land, water and the physical environment in general is such as to secure a long-term good management in ecological, social, cultural and economic terms; and

[321] ibid, Ch. I para 4.

[322] Miljöbalk (1998:808), Translation issued by the Swedish Government: The Swedish Environmental Code Ds:2000:61, Ch 2.

[323] The Swedish Environmental Code, Ch. 1 section 1.

[324] Darpö 2001, p. 71.

[325] Michanek and Zetterberg 2017, p. 98, The list is non-exhaustive and is complemented with environmental goals issued by the parliament.

5. reuse and recycling, as well as other management of materials, raw materials and energy are encouraged with a view to establishing and maintaining natural cycles.[326]

As stated above, sustainable development is the overarching objective, which means that the Environmental Code should be applied in line with this objective. The objective of sustainable development and protecting the environment for future generations is also enshrined in the Swedish Constitution.[327] Consequently, future generations must be protected, which means that companies that engage in harmful activities must not endanger the functions of ecosystems for future generations.[328] Thus, natural resources must be managed with future generations in mind.[329] The application of the Environmental Code is not based on anthropocentric grounds, it is therefore the environment itself that is subject to protection.[330]

In addition to the objectives described above, further objectives are set by the Parliament. Sixteen targets are set out as the environmental goals of Sweden.[331] The goals are not binding but serve as a guide for the interpretation of other provisions of the Environmental Code, to ensure that the interpretation is in line with the overall objective of sustainable development.[332]

Michanek and Zetterberg points out that the Code uses the word "environment", not specific protected areas, which implies a broad application of the provision.[333] The Environmental Code also provides for a reversal of the burden of proof for companies that have or intend to carry out an activity.[334] Therefore, in general, the company has to prove that its activities are compatible with the general principles of Chapter 2 of the Code and that they can be carried out without harming the environment.[335] Thus, anyone intending to operate, or currently operating a business must gather the necessary knowledge about their operations to protect the

[326] The Swedish Environmental Code, Ch. 1 section 1 paras 1-5.

[327] Kungörelse (1974:152) om beslutad ny regeringsform, Ch. 1 section 1 para 3.

[328] Michanek and Zetterberg 2017, p. 96.

[329] ibid.

[330] Michanek and Zetterberg 2017, p. 97.

[331] Sveriges Miljömål "Sveriges 16 miljökvalitetsmål".

[332] Michanek and Zetterberg 2017, p. 100.

[333] ibid, p. 97.

[334] The Swedish Environmental Code, Ch. 2 section 3.

[335] Naturvårdsverket "Vägledning Hänsynsreglerna – kapitel 2 miljöbalken".

environment and people from harm.[336] In addition, appropriate measures shall be taken to prevent, avoid or mitigate harm to the environment and humans using best available technology.[337] Such precautions shall be taken immediately when there is a risk of damage.[338] If environmental damage has occurred as a result of an operator's activities, the operator is responsible for limiting the damage until it ceases to occur, to a reasonable extent.[339] If serious environmental damage or pollution has occurred, the operator is responsible for remedying the damage.[340]

The Environmental Code refers to the operator of the company, but how to define the operator is somewhat unclear as the Environmental Code does not provide any guidance.[341] In some cases it may be obvious who is the operator of a company, but when several companies are involved or when a subsidiary operates under a parent company, it may not be so clear.[342] Darpö has argued that the decisive factors are who has the power and the ability to control the company.[343]

The Swedish Environmental Code is partly the result of several international agreements at EU and international level. The Environmental Code covers the overall objective of sustainable development and protection of the environment, but also more specific areas of protection. However, the Environmental Code does not contain any obligations for companies to exercise due diligence in their operations or in their value chains.

4.2 Possible changes in Swedish legislation and companies' activities

The proposed EU Directive aims to harmonise due diligence requirements in all member states to create a level playing field and legal certainty. The lack of current binding due diligence obligations in Sweden will require significant legislative changes. The purpose of the following

[336] The Swedish Environmental Code, Ch. 2 section 2.

[337] ibid, Ch. 2 section 3.

[338] ibid, Ch. 2 section 3 para 2.

[339] ibid Ch. 2 section 8.

[340] The Swedish Environmental Code, Ch. 10 section 2.

[341] Unofficial translation of "verksamhetsutövare".

[342] Michanek and Zetterberg 2017, p. 263.

[343] Darpö 2001, p. 85.

sections is therefore to outline some of the implications that the proposed EU Directive on Corporate Sustainability Due Diligence may have on Swedish legislation.

4.2.1 Scope

The proposed Directive is to some extent cross-sectorial. Companies with more than 500 employees and an annual turnover of more than EUR 150 million are covered by the Directive, regardless of the sector in which they operate.[344] Certain risk sectors are also covered for companies with more than 250 employees and an annual turnover of EUR 40 million, where half of the turnover is generated in a risk sector.[345] This means that the proposed Directive excludes SMEs from its scope.[346] Member states have some discretion in implementing the Directive. Nevertheless, as one of the overall objectives of the proposal is to create a level playing field for European companies, it has been argued that it is sound to implement the provisions of the proposed Directive as closely as possible to the original drafting,[347] especially since harmonised legislation in the member states provides legal certainty.[348]

However, if Sweden implements the directive in accordance with the minimum requirements set out in the proposed Directive, it will only affect companies with more than 500 employees.[349] 99,9% of Swedish companies are SMEs with fewer than 250 employees. Therefore, the number of companies that would be subject to the obligations is very limited which would significantly limit the impact of the Directive.[350]

Against this background, it can be argued that the proposed Directive should be implemented with a lower threshold to widen its reach. Arguably, the threshold from the implementation of the Non-financial Reporting Directive in the Annual Accounts Act can be used.[351] Companies with 250 employees would thus fall within the scope of the Directive. Swedish companies are

[344] COM(2022) 71 final, Article 2.

[345] ibid, Article 2(1)(b).

[346] ibid, p. 14.

[347] Remissyttrande Dnr V 2022/546, p. 1.

[348] ibid.

[349] COM(2022) 71 final, Article 2, or companies with 250 employees with a turnover of EUR 40 million that operates in a risk sector.

[350] Ekonomifakta “Företagens storlek” (11 March 2022).

[351] The Annual Accounts Act, Ch. 6 section 10.

considered large if they have more than 250 employees.[352] In 2021, there were 1264 large enterprises in Sweden that could be covered by the Directive with a lower threshold.[353]

The Commission has argued that the financial burden on SMEs would be too big compared to that on large companies with more financial assets if they were forced to take measures to comply with due diligence requirements.[354] Conversely, the UN Guiding Principles apply to all companies, regardless of size.[355] The level of due diligence required of companies under the Guiding Principles is determined by factors such as the nature of the company's business and whether it operates in a risk area.[356] Therefore, SMEs or even micro-enterprises may not be obliged to apply the same level of due diligence as large companies, unless their activities are of a high-risk nature. In the same way, the financial burden will differ significantly between SMEs and large companies.[357] However, in certain situations it may be disproportionate to impose due diligence on SMEs. In such cases, it may be necessary to limit SMEs obligations to reporting obligations or to implement due diligence measures only to a certain extent. The competent authority responsible for implementing and enforcing the obligations arising from the proposed Directive may develop further guidance in this respect. In conclusion, it is important to include SMEs in the scope of Sweden's corporate responsibility legislation in order to create a harmonised framework and to ensure that SMEs engaging in environmentally harmful activities take responsibility for their actions.

4.2.2 Due diligence

The Annual Accounts Act requires companies to provide a sustainability report.[358] The report should provide an understanding of the company's activities and the impact that these activities may have on the environment, people and society as a whole.[359] It should also include information on the company's policy, its outcome, and review procedures. In addition, the risks of, *inter alia*, environmental damage should be addressed and how the company manages them,

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[352] Ekonomifakta "Företagens storlek" (11 March 2022).

[353] ibid.

[354] European Commission et al. (2020), p. 318-319.

[355] United Nations Guiding Principles on Business and Human Rights (2011), Principle 14.

[356] ibid, Principle 14 and the Commentary.

[357] ibid.

[358] Annual Accounts Act, Ch. 6 section 10.

[359] ibid, Ch. 6 section 12 para 1.

including adverse impact that may arise from the company's business relationships or as a result of its products or services.[360]

Likewise, the proposed Directive obliges companies to explain the company's approach in a near and future perspective.[361] The policy should include a code of conduct that applies to the company and its subsidiaries.[362] In addition, there must be a statement of compliance measures both for the parent company and for the entities with which it has established business relationships.[363] In contrast to the proposed Directive requiring parent companies to adopt a code of conduct applicable to all companies with which the company has established business relations,[364] the Annual Accounts Act requires sustainability reporting for the whole group.[365]

The main impact of the proposed Directive compared to the present Annual Accounts Act may be the binding obligation for companies in terms of establishing due diligence policies. This is because under the Annual Accounts Act companies are free to choose whether or not to include a particular area in their policies, and then only provide an explanation as to why they have excluded such an area.[366]

Furthermore, Article 6 of the proposed Directive requires companies to identify adverse environmental and human rights impacts, both actual and potential impacts.[367] Under the Environmental Code, companies are also obliged to collect information about their activities in order to avoid harming the environment and human health.[368] The process for identifying risks under the proposed Directive have thus similarities with the environmental impact assessment established in the Environmental Code. According to the Code, companies must identify, describe and assess the environmental impacts of their activities when planning and making decisions.[369] The definition of environmental impact is quite broad and includes temporary, cumulative, direct or indirect effects on human health, animals, biodiversity and other elements

[360] ibid, paras 1-6.

[361] COM(2022) 71 final, Article 5(1)(a).

[362] ibid, Article 5(1)(b).

[363] ibid, Article 5(1)(c).

[364] ibid.

[365] Annual Accounts Act, Ch. 7 section 31a.

[366] Annual Accounts Act, Ch. 6 section 12 para 3.

[367] COM(2022) 71 final, Article 6.

[368] Environmental Code, Ch. 2 section 2.

[369] ibid, Ch. 6 section 1.

of the environment.[370] In addition, if there is a risk of environmental impact in another country as a result of the activities of the undertaking, the authorities of that country shall be informed of the risk.[371] However, this assessment is usually done when a company establishes or starts a new activity and the environmental impact of this activity needs to be assessed. According to the proposed Directive, companies shall take "appropriate measures to identify actual and potential adverse (…) impact"[372]. The appropriate measures are not specified. The environmental impact assessment required to identify risks arising from the company's activities can therefore serve as a guide for the implementation of the proposed Directive in Swedish legislation. Consequently, the proposed Directive extends the obligation to identify risks from the company's own activities to those of its subsidiaries and the value chain, as long as there is an established business relationship.[373]

When potential adverse impact has been identified under Article 6 of the proposed Directive, companies must take "appropriate measures to prevent or (…) adequately mitigate such impact.[374] Correspondingly, the Environmental Code obliges, companies to take precautionary measures to prevent, avoid or counteract damage immediately when there is a risk to the environment or human health.[375] Further, if companies cannot prevent environmental damage, they should remedy the damage or pay compensation.[376] In addition, companies must comply with the general rules of consideration,[377] unless it is economically unreasonable to do so.[378]

The proposed Directive also contains obligations to prevent or mitigate adverse effects, to take action "where relevant",[379] and to take the necessary measures to stop or, if that is not possible reduce the actual adverse effects, and to pay compensation to affected individuals and communities.[380] According to the proposed Directive, the following measures can be taken to

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[370] ibid, Ch 6 section 2.

[371] ibid, Ch 6 section 13.

[372] COM(2022) 71 final, Article 6(1).

[373] ibid, Article 6.

[374] ibid, Article 7(1).

[375] Environmental Code Ch. 2 section 3.

[376] ibid, Ch. 2 section 8.

[377] ibid, Ch. 2 section 1.

[378] ibid, Ch. 2 section 7.

[379] COM(2022) 71 final, Article 7(2).

[380] ibid, Article 8.

prevent, mitigate, end or minimise adverse effects on the environment and human rights. Hence, companies can adopt a preventive action plan developed with stakeholders[381], they can request contractual guarantees for directly affiliated entities to compel them to comply with the company's action plan or code of conduct[382] and apply related control measures.[383] In addition, it may be necessary for companies to invest[384] and collaborate with other entities to improve their prevention capabilities.[385]

Although SMEs are not covered by the proposed Directive, they may still be indirectly affected, as corporate strategies are applied to the established business relationships of the parent company. However, the costs for implementing such policies may be disproportionate for SMEs. Therefore, the parent company may need to provide support to SMEs to implement the parent company's code of conduct or action plan.[386]

In general, the obligations deriving out of the proposed Directive to prevent, mitigate, end or minimise adverse impact on the environment and human rights will have considerable impact on Swedish companies. Sweden already has such obligations under the Environmental Code, but the proposed Directive will force companies to extend the obligations to the entire value chain. Large companies falling within the scope will be affected, they must take measures to manage adverse impact in their value chain. Nevertheless, SMEs may also be affected if they are subsidiaries of the parent company or are part of its value chain and therefore have to comply with the parent company's policy.

Lastly, failure by the parent company to prevent, mitigate, end or minimise the damage could ultimately trigger an obligation to suspend or terminate the business relationship under the proposed Directive.[387] This will have significant implications for Swedish company law and for companies across the value chain.

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[381] ibid, Article 7(2)(a), Article 8(3)(b).

[382] ibid, Article 7(2(b), Article 8(3)(c).

[383] ibid, Article 7(4).

[384] ibid, Article 7(2)(c), 8(3)(d).

[385] ibid, Article 7(2)(e), article 8(3)(f).

[386] ibid, Article 7(2)(d), article 8(3)(e).

[387] ibid, Article 7(5), article 8(6).

4.2.3 Civil liability

Under the proposed Directive, civil liability may arise if a company breaches Articles 7 and 8[388] and adverse impact arises as a result of the breach.[389] Companies efforts to comply with the due diligence obligations set out in the Directive are valued in a civil liability claim.[390] If an indirect partner causes harmful effects, the parent company is not liable, even if there is an established business relationship, unless it is considered unreasonable that the company's actions could have prevented the harm.[391]

The Directive gives individuals the right to claim compensation for damage caused by companies if they fail to comply with their obligations under the Directive.[392] Nevertheless, there may still be hurdles for individual to access justice. Language barriers and lack of knowledge about their rights or inability to physically access courts. It may also be hard for victims to prove the causality between the inaction of the company and the harm that occurred as the circumstances that are required to trigger liability are still somewhat unclear. However, the proposed Directive does not intend to amend member states' rules on civil liability if they provide for stricter liability or cover areas which are outside the scope of the Directive[393].

The Parliament argued for a reversed burden of proof for civil liability in their initial proposal.[394] But the proposal from the Commission did not follow this line.[395] Sweden has adopted a reverse burden of proof in the Environmental Code, which means *inter alia* that operators must be able to prove that their activities will not adversely affect human health or the environment.[396] However, such a reversal of the burden of proof does not apply to civil

[388] ibid, Article 22(1)(a).

[389] ibid, Article 22(1)(b).

[390] ibid, Article 22(2) para 2.

[391] ibid, Article 22(2) para 1, if the parent company meets the requirements of Article 7(2)(b), 7(4), or 8(3)(c) and 8(5).

[392] ibid, Article 22.

[393] ibid, Article 22(4).

[394] European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)).

[395] COM(2022) 71 final, Article 22.

[396] The Swedish Environmental Code, Ch. 2 section 3.

matters.[397] Consequently, it is a disadvantage for individuals that the proposed Directive is not victim-oriented in the sense that the burden of proof lies on the company.

The Fundamental Rights Agency (FRA) has provided an alternative means of determining who bears the burden of proof. The EU could issue criteria setting out the level of proof required for the burden of proof to shift to the company. Because of difficulties for individuals to prove certain business structures and relationships due to lack of information. This would ease the burden on the victim and ensure a higher level of access to justice for victims.[398] In addition, FRA has noted that binding due diligence obligations can improve individuals' access to effective remedies. [399] Establishing a due diligence policy covering parent companies, their subsidiaries and all entities with which the parent company has established a business relationship can help to clarify the link and responsibilities of each entity.[400] By clarifying the relationship and obligations, potential damage resulting from the activities of the parent company and its subsidiaries can be limited.[401]

Consequently, the enforceability of civil liability depends on the ability of the victim to gather evidence against the parent company. Whether the plaintiff can prove that the company failed to comply with its due diligence requirements and that the adverse impact occurred as a result of this failure. And finally, whether the victim can prove the existence of an established business relationship if the harm occurred in a MNE's value chain.

4.2.4 Directors duty

The Swedish Companies Act is the main Act that regulates limited liability companies in Sweden. Shareholders are not liable for *inter alia* environmental impact arising out of the operations of the company.[402] The proposed Directive, however, imposes a duty of care on directors, which may be considered a lower obligation than a due diligence obligation. Board members should therefore consider sustainability, the environment and human rights when

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[397] Darpö 2001, p. 71.

[398] Fundamental Right Agency "Improving access to remedy in the area of business and human rights at the EU level" (10 April 2017).

[399] ibid.

[400] ibid.

[401] ibid.

[402] Companies Act, Ch. 1 section 2.

making decisions, where appropriate.[403] In addition, the director is responsible for establishing due diligence policies and ensuring that adequate due diligence procedures are in place.[404] However, it is also clear that the proposed Directive is not designed to change national corporate structures.[405] Consequently it is up to Sweden to decide whether the Swedish law needs to be amended to reach the objective of the proposed Directive.

As described above, the profit motive may be considered the main purpose of a limited liability company.[406] Economic factors are most important in limited liability companies, as their foundation is based on increasing the value of the company and generating income for shareholders. It has been be argued that an expansion of the profit motive is unnecessary because sustainability and environmental protection are elements which do not conflict with the profit motive.[407] Nevertheless, it may be necessary to revise the Companies Act to recognise the sustainability focus and to ensure that the economic motive is not the only priority. Therefore, the economic purpose of the Company Code should be complemented by a sustainability purpose that is in line with the due diligence and sustainability objectives set out in the proposed Directive.

4.2.5 Competent Authority

Under the Directive, a national authority is responsible for monitoring and enforcing the Directive.[408] As there is no due diligence law with regard to sustainability and environment present under Swedish legislation, there may not be any established authority that is competent to supervise the fulfilment of the obligations arising out of the proposed Directive. Therefore, it may be necessary to establish a new authority that only works with enforcing the proposed Directive.[409] Stakeholders have argued that a new authority should have a close collaboration with EU institutions.[410] In addition, the Swedish authority should engage in a network with

[403] COM(2022) 71 final, Article 25.

[404] ibid, Article 26.

[405] ibid, Recital 63.

[406] Companies Act, Ch. 2 section 3.

[407] Skog, pp. 29-30.

[408] COM(2022) 71 final, See Articles 17-21.

[409] Eduskunta Riksdag "Statsrådets U-skrivelse U 35/2022 rd" (6 May 2022).

[410] COM(2022) 71 final, p. 19.

authorities from other member states.[411] Such collaboration may facilitate a uniform implementation of the proposed Directive.

To conclude, as shown above, sustainability has been incorporated into the Swedish Environmental Code and subsequently into the Swedish Constitution. This shows the overall importance of sustainability for Swedish legislation. Nevertheless, additional legislative measures need to be put in place to incorporate the proposed Directive into Swedish law as it is currently missing laws on due diligence that is directed towards companies' value chains. Although the Swedish government has stressed that the OECD Guidelines for Multinational Enterprises, the United Nations Guiding Principles on Business and Human Rights and the United Nations Global Compact should be applied, these are not implemented in binding law, only in guidelines. This will be changed with the adoption of the EU Directive on Corporate Sustainability Due Diligence, as the binding nature of EU directives requires the implementation of binding legislation in the national legal system.

5 Conclusion

This research aimed to investigate MNEs' due diligence responsibility for environmental harm in their value chains. Legal instruments, both non-binding and binding, have been examined at the international, European and national levels to meet this objective.

The UN Guiding Principles are providing a risk-based approach to due diligence and have implemented Ruggies prevent, protect, and remedy framework that expressively addresses the connection between companies and human rights. The UN Guiding Principles oblige companies to prevent environmental damage arising from their operations and activities in their value chain. In addition, companies should take measures to protect and remedy the damage that has already occurred. Liability varies, however, depending on who caused the damage. Companies are more responsible for their activities than for the activities of their value chain. Finally, the application of due diligence practices does not guarantee that the company is free from liability.

The OECD Guidelines for Multinational Enterprises provide recommendations for companies on how to achieve the overall goal of sustainable development. Companies are required to identify, prevent and mitigate potential or actual adverse environmental impacts arising from

[411] ibid, Article 21.

their operations. Companies should apply a risk-based approach to due diligence. The level of due diligence that companies should exercise is determined by factors such as the size of the company and the nature of its operations. The parent company should try to prevent or mitigate damage caused by an entity directly linked to the company. Likewise to the UN Guiding Principles, companies have a lower responsibility for harm that occurs in the supply chain.

The international framework provides guidance and obligations for companies on how to conduct due diligence in their supply chains and value chains respectively. However, implementation of the voluntary instruments is considered weak. The OECD guidelines have an enforcement mechanism, each member state is obliged to establish a NCP responsible for implementing and enforcing the guidelines. However, the functions assigned to the different NCPs vary widely in national legislation, which has led to a lack of harmonisation. Nevertheless, both the United Nations Guiding Principles of Business and Human Rights and the OECD Guidelines for Multinational Enterprises have provided guidance and formed the basis for the growing body of national and regional due diligence laws.

The comparison of the French and German legislative initiatives on due diligence showed significant differences between the two initiatives. The scope of the French law is cross-sectorial but is limited to companies with a particular corporate form and with more than 5 000 employees in France or 10 000 employees worldwide. The threshold is quite high, but it applies at group level. However, these thresholds for size and legal form conflict with the UN Guiding Principles on Business and Human Rights and the OECD Guidelines, which apply to all companies.

The German due diligence law applies to all types of companies, in line with the international regulatory framework, but is instead limited by the fact that it only applies to companies with 3,000 employees, although it will be amended to 1,000 by 2024. Both French and German legislation apply to human rights and the environment. However, German legislation is limited to a few environmental conventions. The German law's environmental coverage is largely dependent on human rights violations and environmental damage caused as an effect, which is a rather anthropocentric position. The French law gives a broader application by invoking the protection against "serious effects" on the "environment". Nevertheless, the law does not define these terms.

Both French and German legislation requires companies to take measures to identify risks and prevent adverse effects. German legislation also obliges companies to take measures to remedy the damage that has already occurred, while French legislation has no such obligation. The French law requires companies to establish a vigilance plan that applies to entities with which the parent company has an established business relationship. The German law requires companies to adopt a policy that applies to entities in the supply chain that are directly linked to the parent company.

Under French law, the focus is more on stakeholders than under German law. French companies must consult stakeholders when drafting their monitoring plan. German law allows companies to participate in stakeholder communication voluntarily. In addition, the French law on monitoring provides for civil liability for victims affected by the activities of the parent company and of the entities with which it has an established business relationship. The German due diligence law, on the other hand, explicitly excludes civil liability.

The assessment of the proposed EU Directive on Corporate Sustainability Due Diligence showed that it has numerous shortcomings compared to the Parliament's original resolution and the international framework. The proposed Directive applies to companies operating in all sectors across the EU. One drawback that will have a major impact on the reach of the proposed Directive is its limited scope, as it only covers large companies with more than 500 employees. Excluding SMEs from the scope will lead to very limited coverage, as large companies represent only 1% of European companies. The proposal thus runs counter to the Parliament's Resolution, the international framework and the statement made by 100 companies, investors and trade unions arguing that in order to achieve legal certainty, all companies registered or operating in the EU must be covered by the Directive.

The second aim of the thesis was to examine what consequences the proposed directive may have for Swedish legislation. It is clear that if the proposed EU Directive on Corporate Due Diligence and Sustainability enters into force and is subsequently implemented in Sweden, it could have major consequences on Swedish legislation and thus for Swedish companies. However, the impact will depend upon how it is implemented into Swedish law. The scope of the proposed Directive is rather limited as it only covers large companies with more than 500 employees, which represents only 1% of companies in the EU. In addition, the definition of adverse environmental impact is limited to a few listed conventions. Nevertheless, Sweden has an opportunity to implement a stricter scope in line with how the Non-Financial Reporting

Directive was implemented. A threshold of 250 employees would significantly improve the coverage of the proposed Directive, but would still only cover large companies according to the Swedish classification.

In order to avoid an excessive financial burden on SMEs, the level of due diligence they have to perform can be determined according to the nature of their activities and the risks associated with their activities, this is in line with the international framework in which the proposed Directive should be interpreted. This approach to setting due diligence obligations will also reduce the financial burden on SMEs.

The main impact of the implementation of the proposed Directive in Sweden will be the due diligence measures that companies will have to undertake for their value chain. Parent companies will be obliged to adopt a due diligence policy including a code of conduct which they shall enforce throughout their value chain. Hence, companies need to identify the risks that arise in the company or in its value chain. Once a risk has been identified, the company must take action to prevent it from occurring. If the damage has already occurred, the company should end or at least minimise the damage. It may be necessary for companies to adopt an action plan with relevant stakeholders. In addition, companies should pay compensation to the communities affected by their harmful activities. If an entity in the value chain causes the damage and the parent company's actions have no effect, the parent company may have to terminate the contract.

Swedish companies with more than 250 employees have reporting obligations under the Annual Accounts Act. Companies should provide a sustainability report that covers the whole group. Those obligations will be extended to report on obligations of due diligence conduct and will apply to the company's own activities, its subsidiaries and value chain entities. The company must show how its value chain complies with its code of conduct.

Companies may be subject to civil liability claims if they fail to comply with their due diligence obligations under the proposed Directive, and adverse impact on the environment or human rights occur as a result. The burden of proof lies on the victim. However, if the harm occurred in the value chain in another country, it may be difficult for victims to prove that there are established business relationships between the parent company and the entity. This should be taken into account when implementing in Sweden. An alternative could be to reverse the burden of proof to some extent.

An amendment of the Swedish Companies Act may be necessary to ensure that the sustainability objective is introduced. The current profit motive of limited liability companies may allow sustainability to be considered. However, including sustainability as a motive would ensure that sustainability is taken into account during the company's operations. The director will be responsible for incorporating due diligence policies and ensuring that adequate measures are taken to prevent environmental risks from arising and to take steps to stop or minimise damage if it does occur.

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