



# Corporate Sustainability Due Diligence: Ensuring a level playing within the EU

**This paper highlights the Single Market challenges posed by the proposed Directive on Corporate Sustainability Due Diligence in terms of legal fragmentation and lack of harmonisation between Member States.**

## CONTEXT

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Over the past years, the EU enacted a number of laws laying down supply chain due diligence requirements for certain sectors, such as batteries, minerals and deforestation. At the same time, several Member States have introduced national laws on corporate due diligence, requiring companies to act against human rights violations and environmental destruction and exploitations in their entire supply chains.

Companies across the EU recognise the advantages and need of a harmonised EU framework on due diligence to prevent fragmentation of the internal market, ensure legal certainty as regards due diligence requirements and guarantee fair competition among companies operating in the Single Market.

## LEGAL FRAMEWORK

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In February 2022, the European Commission proposed a [Directive on Corporate Sustainability Due Diligence](#) (CS3D), aiming to promote sustainable corporate behaviour along global value chains, increase transparency for investors and consumers and establish a level playing field for businesses, both within the EU and vis-à-vis companies from third countries. The CS3D proposal introduces a set of binding legal requirements on human rights and environmental protection for all sectors and establishes new due diligence obligations for European and non-EU companies and company directors above a certain threshold of employees and turnover. In case of non-compliance, the Directive would provide for various measures and sanctions, such as financial penalties, suspension, or deprivation of public support, and introduce civil liability provisions.

While in theory aiming at creating a level playing field for businesses within the EU and preventing fragmentation resulting from unilateral actions by Member States, in practice, the current proposal fails to provide provisions that limit the ability of a Member State to legislate beyond the provisions of the proposal. As a minimum (standards) harmonisation directive, the CS3D proposal allows Member States discretion in the implementation of the Directive, thus contradicting one of its main justifications, namely, to fight legal fragmentation to guarantee one of the EU fundamental freedoms (right of establishment), ensure fair competition and ultimately stimulate sustainable investment.



## Showcasing Single Market problems – under existing EU legislation

### EXAMPLE

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A European manufacturer of textiles operating and supplying goods across the Single Market and having cross-border value chains could be subject to different requirements depending on the Member State where its subsidiaries are based in, and on the authority or judge who will be in charge of interpreting the rules. One Member State might determine that the company should automatically cancel its relationship with a “risky” supplier whilst another national framework might determine that the company should try to work with such a supplier to solve the situation on the ground. Moreover, while the company might be required to control all its supply chain in one Member State, it might have to monitor only a portion of suppliers in another Member State. Because most value chains have a cross-border nature, companies would be subject to patchworks of rules with multiple interpretations, rendering business impracticable in certain areas.

In addition, if a Member State decides to introduce more stringent provisions at national level than those provided for by the CS3D, a company located in that Member State might be subject to damages and fines due to non-compliance with requirements and harm caused in its value chain, while a company with the same value chain but operating in another Member State with less stringent rules would not be concerned. Besides leading to unequal competition as companies are subject to different requirements based on the location of their activities, this could also result in a forum shopping situation.

Disparities in national corporate due diligence requirements and thus burdensome and complex comparisons of different legal frameworks would make it more complicated and costly for the company to carry out economic activities in another Member State, creating risks and financial burdens whenever the company intends to scale up and establish companies across the EU. Thus, in a nutshell, if adopted as a minimum harmonisation directive, as currently drafted, the CS3D would potentially lead to 27 different corporate due diligence frameworks across the EU, resulting in distortions of competition and fragmentation of the internal market, legal uncertainty and additional costs and complexity for businesses operating in the Single Market.

### HOW TO ACHIEVE BETTER RESULTS

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To limit this harmful fragmentation, **targeted full harmonisation on essential elements** must be ensured ad minimum to avoid discrepancies to emerge between Member States’ transposition laws and guarantee a level playing field for European business. One technique could be to replicate what it is done in EU consumer law directives which include an “internal market or full harmonisation clause”<sup>1</sup>. In accordance with this clause, Member States “shall not maintain or introduce, in their national law, provisions diverging from those laid down in this Directive, including more, or less, stringent provisions, unless otherwise provided for in the Directive”. As the proposal for the Directive is based on Article 114 of the Treaty on the Functioning of the European Union, BusinessEurope would see no legal obstacles for this legal tool to be implemented.

The need for full harmonisation does however not apply to the corporate governance elements of the CS3D. Legislation on corporate governance at EU level is generally more likely to do harm than good. It would interfere with national company law systems and

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<sup>1</sup> See, as example Directive 2019/771 on sale of goods: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L0771>



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could lead to redefining corporate interest in a way that is incompatible with our economic market model. Also, legislating on corporate governance is unnecessary for the purposes of creating a level playing field on due diligence<sup>2</sup>. Therefore, the **deletion of the provisions on corporate governance in the CS3D** will not have a negative impact on the Single Market but is rather necessary to safeguard the global competitiveness of European companies.

## CONTACT INFORMATION

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**Pedro Oliveira**, Director, Legal Affairs Department, [p.oliveira@businesseurope.eu](mailto:p.oliveira@businesseurope.eu)

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<sup>2</sup> See e.g. European Commission (2011), [\*Report of the Reflection Group On the Future of EU Company Law\*](#): “The different corporate governance systems of the Union should not be viewed as an obstacle to free enterprise within a single market, but as a treasure trove of different solutions to a wide variety of challenges that has been experienced and overcome.” (p.11).