Corporate Sustainability Due Diligence in Groups of Companies

The new proposal for a Corporate Sustainability Due Diligence Directive (CSDDD) aims inter alia to ensure that companies undertake to conduct due diligence in its subsidiaries and its value chain. The fact that the duty includes subsidiaries is probably the least controversial aspect. The duty to publish non-financial reports on a consolidated basis already encourages certain companies to conduct due diligence in their subsidiaries and report on this. But still the proposal will have consequences for groups of companies because it turns soft law into hard law by making it a duty to conduct due diligence in subsidiaries and allows for different ways of enforcing this duty. Consequently, the proposed directive may have consequences on how groups are structured and how they operate.

To evaluate the effect that the proposed directive may have on groups it will first in section 2 be analysed when the duty to conduct due diligence is triggered in groups, section 3 analyses how the proposal foresees that the due diligence should be conducted in subsidiaries and section 4 focuses on how the enforcement mechanisms in the proposal may work to protect stakeholders in subsidiaries. In section 5 it will be discussed whether the proposed directive constitutes a (partial) group regulation or whether it is likely to be the trigger of one. Section 6 concludes.

2. WHEN IS THE DUTY TO CONDUCT DUE DILIGENCE APPLICABLE IN GROUPS?

To determine the scope of the groups where due diligence should be conducted, it is necessary first to establish if there is a parent company that qualifies as a ‘company’ under the proposed directive, and thereafter to establish which subsidiaries will be subject to due diligence actions by that parent company.

Keywords: corporate groups, Corporate Sustainability Due Diligence Directive, parent and subsidiary companies

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exercises, even though it may still have to report on its due diligence effort in its subsidiaries according to Article 29a of the Accounting Directive given that the company together with its subsidiaries qualifies as a large group according to Article 3(7) of that directive.

It seems that the proposal is limited to larger companies to avoid imposing burdens on smaller companies.\(^5\) But this does not explain why the proposal does not include larger groups as these may individually be too small to be burdened with due diligence duties, but since they are all part of the same group, the group as such should have the capacity.

The approach chosen by the Commission has a range of consequences that does not seem to further the aim of the directive:

First, it may mean that only part of a group is included. If a group is headed by a holding company that has either not the number of employees or the turnover required under the proposal’s threshold the holding company will not have to conduct due diligence in its subsidiaries. But if one subsidiary has the size that falls under the directive this subsidiary will have to conduct due diligence in its own operations and in its subsidiaries. Other subsidiaries owned by the holding company may escape the duty.

Second, it may be possible for groups to speculate in this and consequently avoid the application of the directive, or at least avoid that it applies to those group companies that are most likely to be associated with human rights and environmental risks. For instance, it may be possible to let the group operate in many companies none of which surpasses the threshold. Alternatively, the group may ensure that part of the group is not included, for instance by making sure that the ultimate parent is a holding company that does not exceed the thresholds, and then letting the holding company directly own those subsidiaries that are most ‘risky’. Given that these ‘risky’ subsidiaries do not themselves exceed the threshold the group will have avoided any potential liability for these.\(^7\)

Third, the chosen solution may result in several companies that are part of a group having to comply with the directive. Take the example that a parent company exceeds the threshold of the directive, and it controls a subsidiary A that also exceeds the threshold, and subsidiary A then again controls a number of subsidiaries (B-D).\(^8\) In this situation the parent company will be obliged to conduct due diligence in its own operations and in subsidiaries A-D, and given subsidiary A is also within the scope of the directive this will have to conduct due diligence in its own operations and in its subsidiaries B-D. Consequently, subsidiaries A-D will be subject to two due diligence exercises which does not make much sense. In comparison a subsidiary that is itself a large undertaking or a parent of a large group does not need to submit a non-financial report as an individual company or a consolidated report as it is released from the duty to do so when it is covered by the parents’ consolidated report, see Articles 19a(3) and 29a(3) of the Accounting Directive. If the same solutions were applied in the CSDDD proposal subsidiary A would be released from its duty to conduct due diligence. But there is nothing in the proposal that suggests this.

It may be considered whether this could easily be solved by subsidiary A by delegating the duty to conduct due diligence to the parent company. This may be possible but it is clear that this does not mean that subsidiary A will be released from its duties under the directive. Inter alia, it will not be released from the liability under Article 22 of the proposal, and therefore stakeholders in subsidiaries A-D may choose which company they will seek compensation from, and they may even go for both.\(^9\) Furthermore, according to Article 26(1) the directors of subsidiary A will have the responsibility ‘for putting in place and overseeing the due diligence actions’. To delegate the task of conducting due diligence to the parent may ensure that they have complied with the duty to put in place due diligence actions, but they will still need to supervise how the parent is conducting this. It may prove a bit awkward for the management of a subsidiary to oversee the management of its parent, but if not, they risk incurring liability. It may be that the parent company and subsidiary A have their registered office in different Member States and as a consequence different implementation may regulate how the due diligence actions must be conducted, and the parent company will need to take this into account when they conduct their due diligence. So it may be that there are ways to avoid conducting the same due diligence twice, but it would have been easier for the companies involved if subsidiary A was exempted from the due diligence duties under the directive.\(^9\)

2.2. Scope of the Group

A company that falls within the definition outlined above will have to conduct due diligence in its own operations, that of its subsidiaries and part of its value chain, see CSDDD Articles 1(1) and 6(1).

In the context of this article, it is mainly the concept of ‘subsidiaries’ that is interesting, and this concept is defined in Article 3(d). First, it

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6 If the ‘risky’ subsidiary is part of the value chain of a company that exceeds the threshold of the directive this plan will not work, since value chain operators should be included in the due diligence effort disregarding whether they are subsidiaries of the company or not.

7 As discussed below the presupposes that subsidiaries B-D are either part of the parent companies’ value chain or that the duty to conduct due diligence includes indirectly controlled subsidiaries.

8 If the parent company and subsidiary A have their registered office in different Member States different national rules will apply to the liability according to Art. 22, and the tort victim may choose to start action against the company that are governed by the most favourable regime. Also, subsidiary A will have to comply with the duty to set up a complaint procedure according to Art. 9. But of course, complaints can be forwarded to the parent company for answering.

9 This was also the solution suggested in the proposal made by the European Parliament for a directive on corporate due diligence and corporate accountability, P9_TA(2021) 0073, Art. 4(6), https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073_EN.htmlbid.
is clear that a subsidiary must be a legal person, but this time there is no references to Annex I and II of the Accounting Directive, and therefore it must be assumed that it may have any corporate form. Also, there is no indication that the subsidiary should be formed in the EU, which is intentional as the directive aims to impose a due diligence duty on subsidiaries anywhere, and consequently it does not matter where they are formed or where they are active. It is also clear that subsidiaries are included whether or not they are part of the value chain of the ‘company’ (hereinafter the ‘company’ will be referred to as the parent company since we are assuming that it has such subsidiaries).

But to identify subsidiaries a group definition is required and here Article 3(d) refers to the definition of ‘controlled undertaking’ found in the Transparency Directive, Directive 2004/109/EC, Article 2(1)(f). This provision covers companies in which (1) the parent company has the majority of the voting rights, (2) the parent company is a shareholder and has the right to appoint or remove the majority of the administrative, management or supervisory body, (3) the parent company is a shareholder and controls a majority of the voting rights in the subsidiary through agreement entered into with other shareholders in the subsidiary and (4) over which the parent company has the power to exercise, or actually exercises, dominant influence or control.

This definition will likely cover most of the companies that are part of a group. The definition will not cover companies which are associated undertakings as defined in Article 2(13) of the Accounting Directive since associated undertakings are only companies over which a significant interest can be exercised, and this is presumed to be the case where it has more than 20% of the votes. Furthermore, the definition of a subsidiary will in most cases not cover joint ventures in which the ‘company’ participates. Joint ventures are often 50/50% owned if there are two joint venture partners, and if there are more these will often own less than a majority of votes in the joint venture. Joint venture partners will normally have extensive veto rights and therefore each will have negative control. But negative control does not equal dominating influence or control according to Article 2(1)(f)(iv). But if a joint venture is structured so that one joint venture partner has more than a majority of the votes (for instance a 40/60% ownership) then the company owning a majority (60% of the votes) will have to conduct due diligences according to Article 2(1)(f)(ii). This will be the case even though the other joint venture partner will often be awarded veto rights that have the effect that the 60% may not be used to control the joint venture. Since it may be awkward that one joint venture partner has to conduct due diligence and the other not, this may be an argument in favour of using the 50/50% solution.

But even though associated undertakings and joint ventures seem not to qualify as subsidiaries, they may still belong to the value chain of the ‘company’. This will be the case where the associated undertaking or joint venture has activities that are related to the business of the ‘company’, see Article 2(g). It may even be that the fact alone that the company has contributed capital, and thus financing to the associated undertaking or joint venture may be enough to qualify it as part of the company’s value chain, see Article 3(e)(i) of the proposal. This provision states that even if the activities of a business relationship are not related to the business operation of the company, the business relation will be part of the value chain if either the company has a commercial agreement with the company or provides financing or insurances. Even though the latter is mainly aimed at financial institutions, it could be interpreted as also including non-financial institutions that invest in associated undertakings or joint ventures.

The proposal does not make it clear whether indirect subsidiaries are included, e.g., a subsidiary controlled by a subsidiary of the ‘company’. These are covered by the definition found in the Transparency Directive according to the supplement to the definition in Article 2(1)(f) found in Article 2(2). But since the proposal does not refer to the later article it would seem that indirect subsidiaries are not covered. This is clearly against the purpose of the proposed directive, as not including indirect subsidiaries will potentially severely restrict the extent of the due diligence duty, and furthermore would make it very easy to avoid due diligence in subsidiaries, since this could be achieved just by inserting a holding company between the ‘company’ and the subsidiaries. The remedy should be to include a reference to Article 2(2) of the Transparency Directive.

The definition in Article 2(d) of the proposal defines subsidiary as a legal person through which the activity of a ‘controlled undertaking’ is ‘exercised’. Could this indicate that it is not enough that the ‘company’ has the ability to control according to the definition, but must actually have exercised such control? The definition in Article 2(1)(f) in the Transparency Directive does not require that control is exercised, which is seen clearly from the
 wording of Article 2(1)(f)(iv), but of course the proposed directive could make this a requirement. But such an interpretation would clearly not fit with the purpose of the directive, since this aims to ensure that a parent company has a duty to use its control, see section 3.2.3. A more plausible reading of Article 2(d) seems to be that it refers to the fact that the activities of the subsidiary are exercised in the legal person that qualify as a ‘controlled undertaking’. This interpretation allows us to conclude that a subsidiary is a company over which a ‘company’ can exercise control as defined above.

3. HOW IS DUE DILIGENCE TO BE CONDUCTED IN GROUPS?

The proposal does to some extent outline how due diligence should be conducted in subsidiaries. Two issues will be briefly discussed here: what part of the subsidiaries’ activities should be subject to due diligence and what action the parent company should take when conducting due diligence in subsidiaries.

3.1. The Extent of Due Diligence in Subsidiaries

As mentioned, the proposed directive requires that a company that falls within the scope of the directive (the parent company) conducts due diligence in its own activities, its subsidiaries, and its value chain. The duty clearly requires that the parent company looks into the activities of a subsidiary, but what about the subsidiary’s value chain? If the subsidiary is part of the value chain of the parent, because the activities of the subsidiary are linked to the activities of the parent, see Article 3(g), then the value chain of the subsidiary will also be the value chain of the parent since indirect business relationships and subcontractors are also covered, see Articles 3(e) and 3(f). But if this is not the case it is far from clear that the parent needs to make due diligence efforts in relation to the value chain of such subsidiaries. For instance, the duty according to Article 1(1)(a) applies to the companies’ ‘that (is the parent companies’) 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’. The fact that the value chain is defined as being part of the company’s business relation and not that of the subsidiaries indicates that the value chain of the subsidiaries will not be covered. There are other parts of the proposed directive that points in the same direction. Article 6 of the proposal may be read differently as it states that companies should take steps to identify adverse impacts ‘arising from their own operations or those of their subsidiaries and, where related to their value chains, from their established business relations’ (italics inserted by author). Here their could refer to the parent company and the subsidiaries, but it could also refer only to the parent companies since they are also mentioned in the plural. It may also be argued that the subsidiaries’ activities are those of the parent company, in which case the term ‘entity with whom the company has an established business relationship’ in Article 1(1) (a) could be interpreted as including the whole value chain of subsidiaries. But this would be stretching the wording quite a bit.

So, a reading of the proposal indicates that not the whole value chain of a subsidiary is included, but only the part that is indirectly part of the parent value chain. However, in many ways this result does not fit well with the purpose of the directive. The soft law instruments which have inspired the directive would include the whole value chain of a subsidiary whether or not it is a part of the parent’s value chain. Also, it would promote the overall purpose of the directive to include the whole value chain of the subsidiaries as this interpretation would extend the due diligence duty to all parts of the value chain where the ‘company’ (parent company) can exercise influence. Thus, the influence a parent company has over a subsidiary may just as well be used to influence the part of the subsidiary’s value chain that is not the value chain of the parent. This is also the reason that all subsidiaries are included whether or not they are part of the supply chain of the parent company.

3.2. Actions Needed When Conducting Due Diligence in Groups

There is a reference in recital 16 of the proposed directive that the due diligence process in the directive should cover the six steps defined by the OECD Due Diligence Guidance for Responsible Business Conduct. This is providing some guideline on how due diligence is to be conducted, although the OECD Guidelines only address the due diligence duties in groups to a limited extent. But some guidance as to these group specific

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14 This is not totally unlikely as the concept of an undertaking in EU competition law only includes subsidiaries over which a parent company exercises control.
15 Another important element of the proposal is that the company is required to adopt a business model and strategy that are compatible with the transition to a sustainable
economy and with the limiting of global warming to 1.5 degree. This business model and strategy should, however, only cover the company that exceeds the threshold in Art. 3 (a) and not the subsidiaries.
16 It may be that the subsidiary has an activity that is not linked to the rest of the group, or it may be linked to a part of the group that is not covered by the scope of the proposed directive.
17 See Art. 3(e) where the term business relationship is key for the definition of the value chain is defined as partners ‘that perform business operations related to the products or services of the company for or on behalf of the company’. See also the wording of Art. 10, first sentence, and of recital 43, first sentence.
18 Thus, the soft law obligation to conduct human rights due diligence under the UN Guiding Principles on Business and Human Rights applies to the business relationships of the business enterprise, and the business enterprise is the whole group, see Principle 17(a) and Principle 14. Also the OECD Principles for Multinational Enterprises include a duty for enterprises to prevent human rights impact by their business relationship, and enterprises are defined as a group, see Principle IV(3) and Comment 9 to Principle II. In both cases the use of a group-based approach – contrary to the entity-based approach of the proposed directive – ensures that the value chain of the subsidiary is treated as the value chain of the parent company.
19 These were issued in 2018 and is, http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf.
issues can be found in the proposed directive, as this addresses the following three actions: First the duty to formulate (and publish) a due diligence policy according to Article 5, next a duty to identify adverse human rights and environmental impacts and closely related hereto a duty to monitor, see Articles 6 and 10, and finally a duty to prevent or end adverse impacts, see Articles 7–8. There is also a duty to report on these matters if the company is not already subject to the non-financial reporting requirement in Articles 19a and 29a of the Accounting Directive, see Article 11. The reporting requirement just supplements existing rules and will not be addressed further here.

3.2.1. Due Diligence Policy

Article 5 spells out the duty to adopt a due diligence policy in some detail. The policy should describe the companies’ approach to due diligence and the processes put in place to implement due diligence including measures taken to verify compliance. This policy must necessarily also include the due diligence conducted in subsidiaries and in its value chain, even though this is not specifically stipulated in the provision.

The due diligence policy should also include a code of conduct for the companies’ employees and this code should also apply to the subsidiaries, see Article 5(1)(b) of the proposal. The fact that the proposal mentioned the subsidiaries and not the value chains indicates that there is an expectation that it will be possible for the parent company to make such group policies. In practice, there will in fact often be group policies of this nature.20 It is not clear what the directive requires of the parent company in this regard. Is it enough to suggest to the subsidiary that it should follow the code of conduct or should the parent company make sure that the management of the subsidiary adopts them, and furthermore make sure that they actually comply with them? It has been pointed out that management in subsidiaries may hesitate to comply with such group codes as they reflect a different culture.21 Therefore it may not be enough just to have the subsidiary sign on to them, as monitoring may be required. Companies are already doing much to ensure that their subsidiaries comply with the group codes,22 but Article 5 makes it a duty to do so, and therefore must set a minimum standard that the parent companies must meet.

3.2.2. Identifying Adverse Impacts and Monitoring the Due Diligence Effort

According to Article 6 of the proposal the parent company must take appropriate measures to identify actual or adverse human rights impacts and adverse environmental impacts in their subsidiaries. This will also require them to scrutinize the value chain of the subsidiaries – or at least in some subsidiaries, see the discussing above.

The parent company also has a duty to monitor their own effort to implement their due diligence policy, and this should be done at least every twelve months or whenever there are reasonable grounds to believe that there is a significant new risk, see Article 10.

Both identifying adverse impacts and monitoring will require the parent company to access information in the subsidiaries. The law governing the subsidiary may allow for such an access, but some jurisdiction may not (clearly) facilitate this.23 Such exchange of information may in some jurisdictions be difficult due to the duty to treat shareholders equally (where there are other shareholders than the parent company) or the duty not to disclose commercial secrets.

The proposal aims to overcome such barriers by stipulating that Member States shall ensure that companies are entitled to share information within their respective groups of companies for the purpose of due diligence, see Article 4(2). This indicates that the Member State must ensure that subsidiaries can share the information the parent company needs. The proposal does not go as far as requiring that the subsidiaries do so. This will normally not be needed in groups as a subsidiary will normally act as required by the parent company, if there is no law hindering it. Another reason for not requiring subsidiaries to share information may be that this could indicate that they have a duty to share relevant information, and any failure to do so could then infringe the law. The solution chosen in the proposal ensures that the parent company is the only one which is imposed duties by the directive.

Information should only be shared if it is in compliance with the applicable competition law. Thus, sharing of sensitive information could constitute a breach of Article 101 TFEU or the equivalent ban found in many national competition law regimes. It will, however, be more likely that sharing information with the value chain infringes such provision than the sharing of information between

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20 This at least was the case with Danish listed companies, where a survey of forty-two parents showed that half had code of conducts, and that these often implied or expressly applied to the whole group, see DänIEL GergyBel Stabö & Karsten Engsig Sørensen, Pursuing CSR Policy in Corporate Groups: Insights in the Operation of Groups from Consolidated Non-financial Reporting, Eur Co. L. R. 51–60 (2018).

21 See Sven Helin & Johan Sandström, Codes, Ethics and Cross-Cultural Differences: Stories from the Implementation of a Corporate Code of Ethics in a MNC Subsidiary, 82 J. Bus. Ethics 281–291 (2008). It may also be that – in particular very detailed – codes may have provisions that are contrary to the law applicable to the subsidiaries, see for instance the case studies by Till Talaulicar, Barriers Against Globalizing Corporate Ethics: An Analysis of Legal Disputes on Implementing U.S. Codes of Ethics in Germany, 84 J. Bus. Ethics 349–361 (2009).

22 These can involve interviews, reporting requirements, onsite inspections etc., see further GergyBel Stabö & Engsig Sørensen, supra n. 20.

a parent company and a subsidiary. For instance, the concept of undertakings used in EU competition law means that a parent company that controls a subsidiary will be part of the same undertaking and therefore any agreement between the two (or any exchange of information) will not be caught by Article 101 TFEU.  

Furthermore, the solution adopted will not ensure that subsidiaries subject to the law of a non-EU Member State will be able to share information. Despite the fact that the text of Article 4(2) does not limit its application to EU companies, it seems clear that the EU will not have jurisdiction to regulate the duties of non-EU subsidiaries.

Article 4(2) also makes it clear that Member States must ensure that it is possible for companies in a group to share resources. There is no indication in the proposal which resources the group companies should share apart from the fact that it should be for the purposes of due diligence. It could mean that the parent company could make expertise (technical or legal) available for subsidiaries, or in principle it could be the other way around. If the sharing is done not to benefit the company but another group company it could be in conflict with the management duties to act in the interest of the company.  

This could be the case if a subsidiary is asked to share resources with a parent company to help the latter to comply with a due diligence duty – a duty that may not be imposed on the subsidiary, see above section 2.1. For instance, the subsidiary could undertake to provide manpower to conduct due diligence on its own value chain. The purpose of the proposed Article 4(2) may be to allow all group companies to chip in to solve the due diligence task imposed on the parent company. If so, the proposal may be a small step in the direction of legalizing the concept of the interest of the group as all companies in the group are asked to work towards solving the duty imposed on the parent company.

Finally, the proposal makes it clear that the parent company should, where relevant, consult with the stakeholders as part of the exercise to identify adverse impacts, see Article 6(4). This includes a duty to consult with the employees of the subsidiaries and other stakeholders in these, see the definition of stakeholders in Article 3(n). The duty to consult stakeholders is also repeated in Article 26(1) and is thus applicable to all steps in the implementation of the due diligence actions.

### 3.2.3. Preventing and Ending Adverse Impacts in Subsidiaries

According to Articles 7 and 8 of the proposed directive the parent company should take steps to first prevent or mitigate adverse impacts and if possible bring these to an end. These provisions require a more active role on the part of the parent company that goes beyond gathering information and monitoring. The question is what exactly the parent company should do given there is a need to act according to Articles 7 and 8?

First it is clear that the directive expects the parent company to take appropriate measures to achieve the aim set out in Articles 7–8. To comply with this the parent company must use the influence it has over its subsidiaries and its value chain, and a range of different leverages are mentioned in recital 29: ownership, factual control, market power, pre-qualification requirements, linking business incentives to performance, cooperation with others, etc. Also, it is stated that they should use whatever influence or measure they can reasonably exercise. It is stressed that it is an ‘obligation of means’, although this is stressed specifically in relation to the value chain, not subsidiaries.

Articles 7–8 of the proposal outline different ways of using contracts to accomplish preventing and ending adverse impacts, i.e., contractual insurances, conclusion of contracts, abstaining from concluding such and even terminating such. But these examples seem not to be focussed on subsidiaries, but on partners which are synonymous with business relations part of the value chain, see Article 3(e) of the CSDDD. Of course, the subsidiaries may be part of the value chain and there may be contracts that can be used as means of pressure, but this is hardly enough, since as outlined above it is presumed that the parent company uses all its influence. That includes the influence it has as a parent company, which opens up for a range of other ways to exercise influence. This raises the question of which steps a parent company is expected to take towards its subsidiaries to comply with Articles 7–8.

The actual provisions of the directive do not address this issue, but according to recital 38, ‘[i]t can be expected that a company is able to bring to an end actual adverse impacts in their own operations and in subsidiaries’. This indicates that the control a parent company has over its subsidiary is equal to the control it has over its own operations, which is to say unlimited. It is certainly a fact that in practice it seems mostly not to be a problem to exercise control over a subsidiary.  

But it seems very far-reaching to think that it will never be a problem. In the OECD Due Diligence Guidelines it is acknowledged that it may cause problems as it is stated: ‘In addition, laws of corporate governance may in some cases limit an enterprise’s ability to control or influence behaviour, such as between shareholders and investee companies, boards and management and parent enterprises and its

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25 Sharing resources may also have tax implications, but nothing in the proposal indicates that these should be solved or minimized by the Member States.
26 It should be added that the duty to share resources according to Art. 4(2) is extended to other legal entities than those belonging to the group. This most likely includes the value chain and if this is the case the argument for seeing this as a rule legalizing the interest of the group appears somewhat less convincing. Also, the rules on sharing resources will be limited to EU-based entities, as already noted above in relation to the sharing of information.
27 See recital 29.
28 See recital 15.
29 There are also indications that for this reason companies focus their due diligence efforts on subsidiaries instead of the value chain where it may be more complicated to conduct due diligence and effect changes, see Lisa Smit et al., Study on Due Diligence Requirements Through the Supply Chain 65 (Jan. 2020). The report is, https://op.europa.eu/da/publication-detail/-/publication/84a0a6fd-4c83-11ea-b857-01aa77eb71a1/language-en.
subsidiaries and/or joint ventures. One may argue that it can hardly be problematic for the management of a subsidiary to help to mitigate or prevent adverse impact of this nature as everyone should be interested in preventing human rights infringements or environmental harm. However, the steps needed may have implications for the subsidiary as it may be prevented from using cheap labour or production methods which are available to their competitors because they are legal in the state where the subsidiary operates. Or it may be that a subsidiary is required to shut down activities to prevent adverse impacts. This will have consequences for the subsidiary, its other shareholders and its employees that may make it difficult for the management in the subsidiary to comply. It must be recalled that the proposed directive does not ensure that the directors of the subsidiary have a duty to take into account sustainability matters, as this is only an obligation for the parent company, see Article 25. Also, the home state of the subsidiary may have an interest in making sure that subsidiaries are opposing decisions taken by the parent company which may be harmful to the business of the subsidiary and thereby the economy of the home state. The home state may not have adopted rules similar to those found in the CSDDD proposal and may have different priorities. The result could be an attempt to ‘ring fence’ the subsidiaries in their jurisdiction.

So, it cannot be ruled out that in some cases the parent company may encounter problems in controlling the subsidiary. If it is not enough to ask the subsidiary politely, and the contractual remedies outlined in Articles 7–8 do not seem feasible, the question arises what steps the parent company should take?

One could contemplate whether the proposed directive implicitly authorizes the parent company to give the subsidiary instructions and thereby overruling any restriction that may be found in the law applicable to the subsidiary. But there is nothing in the directive to indicate that it interferes with the company law applicable to the subsidiary in this way as the only indication that the company law applicable to the subsidiaries should be affected is found in Article 4 (2), which is discussed above. If the subsidiary is a company covered by Article 2(1) and therefore subject to the duty to take into account sustainability matters according to Article 25(1) it will certainly be easier for the subsidiary to comply with any request from the parent company to mitigate, prevent or end harm, but again it hardly allows the conclusion that they are under a duty to act as instructed. The directors of the subsidiary must be able to make their own decision on what is in the best interest of the company.

If the parent company cannot issue instructions, it may be relevant to consider other steps. Should the parent company call a general meeting to discuss or decide on the issues? Should the parent company dismiss the management of the subsidiary and elect a new more ‘compliant’ management? Both steps are normally among the leverage that is available to parent companies, and the directive seems to indicate that they should use whatever leverage they have.

It may also be contemplated whether the parent company – if it is unable to influence the subsidiary otherwise – should sell the subsidiary or close down its operations? The proposal seems to regard termination of a business relationship as only appropriate when it is a last resort, but this is only indicated in relation to the value chain, not in relation to existing subsidiaries. Thus, it remains open whether such a step is necessary or even helpful.

Another leverage that the parent company may contemplate is investment in the subsidiaries to make it easier for it to avoid adverse impacts in its own operations or that of its value chain. According to Articles 7(2)(c) and 8(3)(c) the company should consider making necessary investments in management or production and processes and infrastructure to achieve the aims set out in Articles 7 and 8. It is not stipulated where the company should invest and the examples used in the recital seems to point towards the value chain.

However, there is nothing that prevents an interpretation that also includes investment in subsidiaries. Even though the parent may not be obliged to invest in subsidiaries, it may prove helpful if it comes to contemplating sanctions according to Article 20, as the authorities must take into account any investment made. Also, investment may make a liability according to Article 22 less likely.

4. ENFORCEMENT OF THE DUE DILIGENCE DUTIES

The proposed directive introduces a number of enforcement mechanisms that aim to ensure that companies comply with the due diligence duties, and these mechanisms are also applicable when due diligence is conducted by a parent company in its group.

30 See OECD, supra n. 23, at 79.
31 Assuming, of course, that the subsidiary is not itself qualifying as a company in Art. 2.
32 This is particularly true where the state has been part of problem, see further Paul Davies, Ending Human Rights Abuses in Which Companies and States Are Complicit, OBLR (5 Apr. 2022). But even without having so involved the state may have an interest in preventing the steps most harmful to the local economy.
33 Ring fencing is a term that has previously been used in banking law for steps states may take to prevent that a subsidiary in a financial institution’s group policies, see further Thom Wetzer, In Two Minds: The Governance of Ring-Fenced Banks, 19 J. Corp. L. Stud. 197–249 (2018).
34 It may be contemplated whether minority shareholders may be able to challenge such steps, where the parent company is trying to influence the subsidiary to take steps that may harm the subsidiary economically (but help prevent adverse impact to human rights and/or the environment). This needs to be decided according to the law applicable to the subsidiary.
35 See Arts 7(5)-(6) and 8(6)-(7).
36 At least exiting the subsidiary may not affect any change if the subsidiary is able to continue afterwards as before.
37 See recitals 34 and 39. In both recitals the references are to investments in SMEs that are part of the value chain.
38 It is only mentioned in Art. 22(2), last paragraph that investments should be weighted in when evaluating liability, and the situations covered by Art. 22(2) are less likely to be relevant for subsidiaries, see s. 4.3. However, even if not expressly stated it seems relevant to take such investment into account in cases where stakeholders in subsidiaries seek to hold the parent company liable. This, however, needs to be decided by national law.
These include a complaint mechanism, enforcement through the supervisory authorities in the Member States and finally, the possibility to make the parent company liable for damages inflicted on stakeholders in the subsidiaries. Furthermore, it may be contemplated whether the directors of the parent company may face liability.

4.1. Complain Mechanism With the Parent Company

According to Article 9 of the proposal the companies – in our case the parent company – must provide for the possibility that certain persons and organizations may submit complaints where they have legitimate concerns regarding actual or potential adverse human rights impact and adverse environmental impacts of the operation of the parent company, its subsidiaries, and its value chain. Consequently, if there is a concern about the adverse impact of the subsidiaries these should be addressed in a complaint to the parent company. 39

Those who may complain are listed in Article 9(2) of the proposal. It includes persons affected by the adverse impact and this will include the stakeholders in the subsidiaries who suffer the adverse impact by the subsidiary. This is obviously the case with workers in the subsidiaries who may have their human rights infringed, but also other stakeholders in the subsidiaries who may suffer from human rights infringement or adverse environmental impacts. But it could also include minority shareholders and other creditors in the subsidiaries. Even though such stakeholders may not suffer a direct loss they will still be ‘affected by the adverse impact’ according to Article 9(2)(a). For instance, if the subsidiary is inflicting environmental harm this may eventually harm the subsidiary as it may have to pay compensation or close part of its operations, and therefore it is difficult to say that these stakeholders are not affected.

According to Article 9(2)(b)-(c) trade unions and civil society organizations may also complain, but only if the unions represent workers working in the supply chain, or if the civil society organizations are ‘active in the areas related to the value chain’. The wording seems to exclude unions and organizations working with stakeholders in the parent company or its subsidiaries. Why these should be excluded as complainant is not obvious.

The directive only gives a few indications of how the complaint procedure should operate. First the parent company needs to establish a procedure for handling the complaint and this procedure should be disclosed to relevant workers and trade unions. This could include the workers in the subsidiaries and possibly the trade unions representing these, see the discussion above. If there is a well-founded complaint the adverse impact pointed out in the complaint should be deemed as identified according to Article 6 of the proposal, see Article 9(3), with the effect that the parent company has to address this according to Articles 7–8, see above in section 3.2.3. Ignoring a complaint may therefore be an infringement of the due diligence duties and may consequently attract sanctions and civil liability, see further below. Furthermore, Article 9(4) ensures that the complainants are entitled to request a follow-up of the complaint from the parent company and the right to meet with the company’s representatives ‘at an appropriate level’ to discuss the complaint.

4.2. Enforcement Through the Supervisory Authorities

Member States should appoint a supervisory authority to supervise the due diligence rules in the directive, see Article 17 of the proposal. For EU companies that exceed the thresholds in Article 2(1) the competent supervisory authority should be that of the Member State in which the company has its registered office, i.e., the state of incorporation. For non-EU companies exceeding the thresholds in Article 2(2) it will be the state in which the company operates a branch in the EU, see further details in Article 17(3).

The supervisory authority shall supervise all the key provisions regulating due diligence found in Articles 6–11, see Article 17(1), which for some reason leaves the obligation to integrate due diligence and develop a due diligence policy according to Article 5 outside the scope of supervision.

The supervisory authority may initiate an investigation on its own motion or as a result of a substantiated concern submitted by any legal or natural persons, see Article 19. Such a concern can be submitted whenever a person has reasons to believe that a company is failing to comply with the national provisions adopted to implement the directive. It is stressed that the concern should be based on objective circumstances, see Article 19(1). It is not only the subsidiary or any of its stakeholders that may submit a concern but anyone who happens to have relevant knowledge. The concern may be submitted to any supervisory authority, but if the parent company is subject to another Member State’s authority it should be referred to that authority, see Article 19(2).

If the concern is substantiated the competent authority needs to act and it may carry out inspections in compliance with national law. This will allow inspection of the parent company, and any local subsidiaries (and local operators part of the value chain) but will not allow the competent authority to make inspections in foreign subsidiaries. However, for that purpose they may seek assistance from supervisory authorities in other Member States, see Articles 18(3) and 21(2). For subsidiaries in non-EU states the proposed directive does not provide any solution as to how these should be inspected.

If the authority finds that the parent company has infringed the due diligence duties of the directive the company should have the power to order the cessation of infringements, it may adopt interim measures to avoid the risk of severe and irreparable harm and it

39 If the subsidiary is itself a ‘company’ as defined in Art. 2 of the proposed directive the subsidiary must also have a complaint mechanism itself. In this case, however, it must be possible to delegate to the parent company to handle complaints to avoid that two complaint mechanisms cover partly the same companies and value chain operations.
may impose pecuniary sanctions, see Article 18(5). All these steps may be imposed on the parent company as it is this company and not the group that has obligations under the directive. Following this approach, the pecuniary sanctions should be based on the company’s turnover, not that of the group, see Article 20(3).

4.3. Civil liability for the Parent Company

One of the most controversial aspects of the proposal is the possibility to make companies liable for damages if they fail to comply with the obligations laid down in Articles 7 and 8 of the proposed directive, see Article 22. It is not possible here to go into any detail with the implications of this provision, however, a few group-related issues will be addressed.

First of all, the liability should be imposed on the parent company (given that this is the company fulfilling the condition in Article 2) according to the national law in the Member State in which the parent company has its registered office, see Article 2(4). This law applies even if the law applicable to the claim points towards a different jurisdiction, see Article 22(5).40 A subsidiary will not be subject to liability under Article 22 of the proposal unless it itself is a company as defined in Article 2. However, if the subsidiary is involved in violating human rights and/or inflicting environmental harm, the subsidiary may also be liable according to the law applicable to it, and the directive makes it clear that this liability is not affected by the proposed directive, see Article 22(3).

Nevertheless, such a liability may have consequences as a claimant seeking damages can only collect them once. If the subsidiary covers the damages, there will be no claim against the parent company.

The liability for damages applies if a person (natural or legal) suffers a damage as a consequence of the parent company having not complied with Articles 7 and 8 and this failure has resulted in the adverse impact having not been ended or mitigated as foreseen in the directive. This raises at least two questions: who may seek damages in groups and what type of failure merit damages in group settings?

Those who seek damages according to the national implementation of Article 22 must have suffered a damage as a result of either an infringement of human rights or environmental harm.41 If a person suffers direct harm due to such violations, they may bring a claim for damages. This is also the case if the harm is caused by a subsidiary, if the parent company should have prevented or mitigated the damage. It is less clear if persons who may suffer indirect damages may rely on Article 22. This could be the subsidiary itself or minority shareholders or creditors in the subsidiary. If a subsidiary causes environmental damages and suffers a loss as a consequence (because they have to pay damages according to the applicable law or because they suffer reputational loss), the subsidiary could be said ultimately to have suffered a damage because the parent company may not have acted to prevent the environmental harm. In this case the subsidiary will normally have acted culpably itself and this may prevent it from making a claim for damages. But what about the minority shareholders who suffer an indirect loss or the creditor who may not be paid because the subsidiary is insolvent? The proposed directive does not make it clear whether such indirect damages may be covered by Article 22 and consequently will depend on how it is implemented in national law whether or not such claim may be covered. It will probably be a correct implementation if such indirect claims are cut off.

The proposed directive does only partially address what it takes to be made liable or to escape liability. Thus, national law will decide most aspects of the liability including issues such as the amount of fault required, the issue of causation and the requirement for proof of a loss.42 Some jurisdictions have already allowed for parent companies’ direct liability in certain cases,43 but the proposed directive is likely to make it easier to establish liability for the particular kind of damages addressed by Article 22. Not only will the proposed directive codify the option for liability in national law, but it will also clearly indicate which duties the parent company has and that a violation of these may form the basis for liability. Whereas direct liability was less likely if the parent company abstained from monitoring and engaging in their subsidiaries,44 liability under the new regime seem more likely for parent companies that fail to monitor and engage.

As mentioned, the proposal does address a few aspects of the liability. First, there is a presumption that a company will not be liable for damages if it has complied with some of the actions outlined in Articles 7 and 8, see Article 22(2). The actions referred to in Articles 7 and 8 all involve the use of contractual assurances which as mentioned above is likely to be less relevant in relation to subsidiaries.45 Therefore, it is unlikely that the parent company will

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40 For non-EU companies there is no rule similar to Art. 2(4) that states which law they are subject to. It is clear, however, that they are subject to the supervision authority in the Member State where they operate a branch, and if they operate several branches or no branches in the EU the Member State where the company generates the largest annual turnover, see Art. 17(2). It must be the intention that the rule in Art. 17(2) should also define which national implementation of the directive the non-EU company is subject to, but it could have been stated clearer.

41 There is an Annex detailing which human rights and which environmental convention that must be violated, see Arts 3(b)-(c).

42 See recitals 56 and 58.


45 According to recital 57 the aim of the provision is to exonerate the company from liability in relation to indirect business relationships.
find itself in a position where there is a presumption against it being liable for the damages inflicted by its subsidiary. As a result, the parent company is faced with the difficult question of how it must exercise its influence over its subsidiary to avoid liability, see the discussion in section 3.2.3. There is, however, an indication of what elements should be considered when determining the existence and extent of the liability. First, account should be taken to the company’s effort to comply with any remedial action required of them by a supervisory authority in so far as it relates to the damage in question, and second, account should be taken of any investment made or support provided pursuant to Articles 7 and 8, see Article 22(2), second paragraph, which must include investment in and support to subsidiaries, see above section 3.2.3.

4.4. Civil Liability for the Directors of the Parent Company

According to Article 26 the directors of the company – in our case the parent company – shall have the responsibility of putting in place and overseeing the due diligence actions in Articles 4 and 5. Since Article 4 refers to all the due diligence duties laid down in Articles 5 to 11 the directors are responsible for implementing and monitoring all the duties outlined above. Most importantly, this duty, however, only applies to EU companies having their registered office in a Member State, and similar duties are not imposed on non-EU companies. Furthermore, according to Article 25 of the proposal directors of EU companies have a duty to take into account the consequences of their decisions on sustainability matters when fulfilling their duty to act in the interest of the company. These provisions raise a number of questions, but here only the question of the director’s civil liability in groups will be addressed. If the directors fail to implement or monitor the parent company’s due diligence actions, they will have acted contrary to Article 26 and potentially also Article 25. Consequently, they may face liability towards the parent company. But it is also worth considering whether they may be liable directly towards stakeholders in the subsidiary who may have suffered damages due to the failure of the parent company to conduct a proper due diligence. The directive is not clear whether the directors have a duty to protect these stakeholders. There is little doubt that the aim of the due diligence actions is to protect their interest, but neither Article 25 nor Article 26 makes it clear that the directors have a duty to protect such stakeholders of the company. Therefore, it will depend on national company law to what extent the rules on director’s liability will allow for such claims from others than the company that employs the directors. National company law differs in this respect, but it seems that if those raising the claim against the directors also have a claim against the company, for instance under Article 22 of the proposed directive, then as creditors they may in some jurisdictions have a claim against the directors where the company is not able to cover their claim.

4.5. Can Groups Exploit the Differences in Enforcement Regimes?

As outlined above an EU company is subject to the supervision of the authorities in the Member State in which it has its registered office, and additionally the law of that Member State will govern the civil liability according to Article 22. As the national regulation of liability differs the implementation of Article 22 is likely to have different effects in the Member States. The supervision undertaken by the supervisory authorities in the different Member States according to Articles 17–20 should be more similar, but many details are not regulated. Furthermore, the Member State may have an incentive to offer lax enforcement to attract (parent) companies. As a consequence, companies that exceed the thresholds in Article 2(1) of the proposal may contemplate whether there are some jurisdictions that offer a better regime and may choose to incorporate in or make a conversion into – the most favourable jurisdiction.

If a parent company will opt for a more favourable jurisdiction, it will be enough for it to incorporate in the jurisdiction of choice as this will fixate the registered office and thus the jurisdiction according to Articles 2(4) and 17(2). The proposed directive only focuses on the registered office and does not require that the company has any activities in that Member State. If a company that exceeds the threshold subsequently converts into a company in a more favourable jurisdiction it may be that this will be caught by the abuse-mechanism that the Member State should introduce according to Article 86 which was adopted in Directive 2019/2121 amending Directive 2017/1132, and is in the process of being implemented in the Member States.

5. IS THE PROPOSED DIRECTIVE A (PARTIAL) GROUP LAW REGULATION?

It may be contemplated whether the proposed directive introduces a group law regulation. Even though the legal basis of the proposal is Articles 50(1) and (2)(g) of the TFEU, the new directive will not

46 The term ‘director’ is defined in Art. 360 as any member of the administrative, management or supervisory bodies of a company, the chief executive office and if such function exists, the chief executive officer, and finally all persons performing functions similar to those performed by the persons mentioned.


48 See also Mariana Pargendler, The EU Proposal on Corporate Sustainability Due Diligence and the Mystique of Compete Corporate Separateness, OBLR (11 Apr. 2022).

49 The Member States may require a certain connection to the state of incorporation, see the overview of the different requirements in Carsten Gerner-Beuerle et al., Study on the Law Applicable to Companies 134–138 (Jun. 2016). The report is, https://op.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1 In comparison the solution for non-EU companies focuses on where the company has a branch and thus activities, and in the case of several branches or no branches the Member State where the company has the most turnover. This solution may make jurisdiction shopping less likely, although not impossible. The non-EU company may decide to encapsulate the activities in some Member States in subsidiaries and thus only conduct business in their own name in the jurisdiction of their preferred choice.
amend the Company Law Directive, Directive 2017/1132/EU, but it will be an independent directive. The directive clearly also goes beyond the group law normally found in Member States as it not only regulates the relationship between the parent company and its subsidiaries, but also between a company and its value chain.

That being said, there are several elements in the present proposal that may be seen as a group law regulation, and which will be innovative in many Member States. First, the directive addresses the duties of directors who are managing a company that is part of a group. It requires that directors in a parent company are supervising part of the activities in the subsidiaries, and even that they try to influence the subsidiary to prevent, mitigate or end adverse impacts. Such a duty to supervise and control subsidiaries will be an innovation in many Member States.50 Also the directive may indicate that directors in a parent company must take into account the interest of some of the stakeholders in a subsidiary. As mentioned, Articles 25 and 26 of the proposal does not explicitly say this but it may be inferred indirectly by the fact that the parent companies’ due diligence actions also aim to protect stakeholders in the subsidiaries. Again, this will be a novelty in many jurisdictions.51

On the other hand, the directive does not address the duties of subsidiaries, apart from allowing the subsidiaries to share information and resources with other group companies. In particular, the directive does not address the duties of the directors of the subsidiaries. It may be assumed that they are willing to follow instructions from the parent company, but it is not made clear that they have a duty to do so, nor is it ensured that they are always allowed to follow instructions. The duties of directors in subsidiaries are one of the key issues in the regulation of groups, and the omission to address this makes it very incomplete as a group law. On the other hand, it is hardly surprising that this issue is not addressed as it would raise a number of issues about the protection of minority shareholders and creditors in the subsidiaries. Also, it seems that it may not be a pressing issue as the directors of the subsidiaries are likely to do as instructed in most cases.52 But as pointed out, it cannot be ruled out either that conflicts may arise.

The proposed directive aims – also – to protect stakeholders in subsidiaries, and in this respect, it seems very much in line with traditional group law. Group law, however, will normally focus on protecting the minority shareholders and creditors of the subsidiary (and maybe the workers by ensuring them representation rights in the parent company’s board). The proposed directive mainly aims at other stakeholders, i.e., those who suffer from human rights infringements and adverse environmental impacts. Thus, the focus is slightly different, although it may be possible that also other creditors and minority shareholders may be able to invoke some protection under the directive.

Finally, the proposed directive addresses the liability for parent companies for harm inflicted on the stakeholders in the subsidiaries who suffer from inadequate due diligence efforts. Normally group law addresses the parent companies’ liability for harm inflicted on the subsidiaries themselves, and this type of harm seems less likely to be covered by the directive. The directive may also have as a consequence that the parent company will find it very difficult to escape liability for fines and damages caused by an infringement of EU competition law by the subsidiaries. The concept of an undertaking means that a parent company that controls its subsidiary will be liable for such claims,53 and if a parent company has a duty to conduct due diligence in the subsidiaries according to the directive, it will be very difficult for it to argue that it does not exercise control over the subsidiary. If they claim that they do not exercise control, the parent company is likely to be liable according to Article 22 for any damages inflicted by the subsidiaries since the directive required it to exercise control under the directive. Here the parent company is caught between a rock and a hard place.

So, there are some elements of group law in the proposed directive, but often the approach of the directive differs from the approach usually used in more traditional group law. Therefore, it is hardly a group law, but it may trigger a development that foster a more complete group law. Thus, if there are problems with controlling the management of subsidiaries a logical next step is to make it clear that they also have a duty to work towards preventing, mitigating and ending adverse impact and thus act in the interest of the parent company. Also, it may be that the duty to supervise subsidiaries will as a consequence of the directive evolve to other areas, such as risk management. If the parent company is already collecting information from and monitoring subsidiaries in respect of human rights and the environment, it seems easy to expand this exercise to other areas of the subsidiary’s activities and the shareholders of the parent company may come to expect this. If as a consequence of gathering information the parent company discovers that there are problems in the subsidiaries not related to human rights and the environment but other important aspects of the subsidiaries, it would seem that the parent company needs to act on this. This may also trigger a development where oversight of subsidiaries will cover more areas. The Commission has already in 2012 committed itself to make a proposal concerning the interest of the group, and the proposed directive may form the right platform for doing so.54

50 See for instance Karsten Engsig Sørensen, The Legal Position of Parent Companies: A Top–Down Focus on Group Governance, Eur. Bus. L. Org. L. Rev. 423–474 (2021), where it is concluded that such duties do not exist in Danish and UK law and only partially exist in German law. A study of the OECD, supra n. 23, indicates that in some jurisdiction the duty to oversee risk management may extend to oversee risk to which material subsidiaries and other group companies may be exposed, see Table 1.7.

51 Probably not in Germany, but in Denmark and the UK, see Engsig Sørensen, supra n. 50.

52 For a similar reason the Informal Company Law Expert Group (ICLEG), in its ‘Report on the recognition of the interest of the group’, dated Oct. 2016, did not propose to introduce a right for a parent company to give instructions, see at 45.

53 See for instance Whish & Bailey, supra n. 24, at 97–100.

6. CONCLUSIONS
The proposed directive aims to ensure that certain large companies conduct due diligence in their subsidiaries. The directive uses an entity approach instead of a group approach and consequently some groups may not be covered by the directive or only partially covered, even though the group is large enough to bear the burdens imposed by the directive. The entity approach also has as a consequence that it becomes uncertain whether the value chain of a subsidiary is always to be included in the due diligence and it may create a situation where several companies in the same group have to comply with the directive, thus duplicating their due diligence efforts.

The directive presumes that the parent company is able to control its subsidiaries, but it does not grant the parent company a right to do so. Nor does it align the duties of the directors in the subsidiaries and the parent, nor does it address how the parent company should go about controlling its subsidiaries. As a consequence, it seems likely that some of these issues need to be addressed when stakeholders in subsidiaries start suing parent company for damages according to Article 22 of the proposal.